Petition

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81-1672

Office - Supreme Court, U.S.
FILED
MAR 10 1982
[illegible] STEVAS.
CLERK

No. 81-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

PENNZOIL COMPANY,
Petitioner,
v.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Supreme Court of Appeals erred by upholding a decision of the Public Service Commission of West Virginia that interprets the definition of "first sale" set forth in Section 2(21) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301(21), in a way that directly conflicts with the holding of the United States Court of Appeals for the Fifth Circuit in *Mid-Louisiana Gas Co.* v. *Federal Energy Regulatory Commission*, 664 F.2d 530 (1981) *reh'g denied* ——F.2d —— (5th Cir. 1982), which held the identical interpretation to be contrary to the intent of Congress.

2. Whether the Supreme Court of Appeals erred by upholding a decision of the Public Service Commission of West Virginia that purports to set a price for a "first sale" of natural gas in interstate commerce in violation of the intent of Congress and in excess of the authority delegated to the State of West Virginia in Section 602 (a) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3432(a).

PARTIES BELOW

The Petitioner in this case who participated in the case below is:

Pennzoil Company*

The other parties in the case below were:

Public Service Commission of West Virginia

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* The following companies are the non-wholly owned subsidiaries of Pennzoil Company: National Transit Company; Pennesco, Inc.; and the Eureka Pipe Line Company.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED FOR REVIEW i

PARTIES BELOW ii

OPINIONS AND ORDERS BELOW 1-2

JURISDICTION 2

STATUTES INVOLVED 2

STATEMENT OF THE CASE 2

A. Introduction 2
B. The Effect of the Natural Gas Policy Act 3
1. The NGPA concept of "first sale." 4
2. The power delegated to the states under Section 602 of the NGPA. 6
C. Facts 7

REASONS FOR GRANTING A WRIT 15

I. THE "FIRST SALE" QUESTION

A. The Decision Of The West Virginia Supreme Court Is In Direct Conflict With The Fifth Circuit. 16
B. West Virginia Has No Power To Adopt An Interpretation Of The Term "First Sale" That Conflicts With Federal Law. 17
C. The Consequences Of The West Virginia Decision. 19

II. THE QUESTION OF STATE AUTHORITY 20

A. Pennzoil's First Sale Is Not In Intrastate Commerce. .. 21
B. The West Virginia Legislature Has Not Exercised Its Authority Under Section 602. 23
C. Section 602 Precludes Establishment of Rates On A Case-By-Case Basis. 25

Table of Contents Continued

Page

D. Potential Consequences Of The Commission's Assertion Of Authority. 27

CONCLUSION 29

APPENDIX

TABLE OF CITATIONS

Cases

California v. *Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965) . . . 22

California v. *Southland Royalty Co.*, 436 U.S. 519 (1978) . . . 18

Deep South Oil Co. v. *FPC*, 247 F.2d 882 (5th Cir. 1957), *cert. denied* 355 U.S. 930 (1958) 22

Eureka Pipe Line Co. v. *Public Service Comm'n*, 148 W. Va. 674; 137 S.E.2d 200 (W. Va. 1964) 23

FPC v. *Amerada Petroleum Corp.*, 379 U.S. 687 (1965) 22

Hecht Co. v. *Southern Union Co.*, 474 F. Supp. 1022 (D.N.M. 1979) 26

Louisiana Public Service Comm'n v. *FPC*, 359 F.2d 525 (5th Cir.), *cert. denied*, 385 U.S. 833 (1966) 22

Mid-Louisiana Gas Co. v. *FERC*, 664 F.2d 530 (1981) *reh'g denied*, —— F.2d —— (5th Cir. 1982) . . . . *passim*

Oklahoma v. *FERC*, 494 F. Supp. 636 (W.D. Okla. 1980), *aff'd* 661 F.2d 832 (10th Cir. 1981), *petition for cert. filed*, 50 U.S.L.W. 3550 (U.S. Dec. 21, 1981) (No. 81-1232) . . 3

Pennzoil Co. v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 50 U.S.L.W. 3547 (U.S. Jan. 11, 1982) (No. 81-340) 18

In re Permian Basin Area Rate Cases, 390 U.S. 747 (1968) . . 28

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) . . . 28

United Gas Improvement Co. v. *Continental Oil Co.*, 381 U.S. 392 (1965) 18

United Gas Pipe Line Co. v. *McCombs*, 442 U.S. 529 (1979). 22

STATUTES

Page

Natural Gas Act of 1938, 15 U.S.C. §§ 717 *et seq.*
  Section 1(b), 15 U.S.C. § 717(b) 7

Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3421 1
  Section 2(21), 15 U.S.C. § 3301(21) 2, 4, 9
  Section 2(34), 15 U.S.C. § 3301(34) 25
  Section 101, 15 U.S.C. § 3311 20
  Section 102-109, 15 U.S.C. § 3312-19 4
  Section 501, 15 U.S.C. § 3411 .... 5, 17, 20
  Section 503, 15 U.S.C. § 3413 9
  Section 506, 15 U.S.C. § 3416 18
  Section 602, 15 U.S.C. § 3432 .... *passim*

Kansas Natural Gas Price Protection Act,
  Kan. Stat. Ann. §§ 55-1401 to 1415 (Supp. 1980) 27

Oklahoma Natural Gas Price Protection Act,
  52 Okla. Stat. Ann. §§ 260.1 to 260.13 (Supp. 1980) .. 27

New Mexico Natural Gas Pricing Act,
  N.M. Stat. Ann. §§ 62-7-1 to 62-7-10 26

West Virginia Code
  § 22-4-1 9
  § 24-1-1 8
  § 24-2-1 23
  § 24-2-13 24
  § 24-5-1 12

ADMINISTRATIVE AUTHORITIES AND REGULATIONS

FERC Order No. 58, [Regulations Preambles 1977-1981 Transfer Binder] Fed. En. Reg. Comm. (CCH) ¶ 30,101 (Nov. 20, 1979) 5

Independent Oil & Gas Assoc., "Order Accepting and Approving Settlement," 55 F.P.C. 1296 (1976) 10

OTHER SOURCES

	Page
H.R. Rep. No. 1752, 95th Cong., 2d Sess., *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983	6, 17, 20, 21
Note, *Legislative History of the Natural Gas Policy Act: Title I,* 59 Tex. L. Rev. 101 (1980)	25
Committee Report on H.B. 2680, Kansas Journal of the House 962 (1978)	27
Rules of the Supreme Court of the United States, Rule 17.1(b)	17

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OF WEST VIRGINIA,
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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

Pennzoil Company (Pennzoil) petitions for a Writ of Certiorari to review a decision of the Supreme Court of Appeals of West Virginia denying Pennzoil's Appeal from an order of the Public Service Commission of West Virginia. The order of the Public Service Commission erroneously interpreted the provisions of Sections 2(21) and 602(a) of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301(21) and 3432(a).

OPINIONS AND ORDERS BELOW

The decision of the Supreme Court of Appeals of West Virginia in *Pennzoil Co.* v. *Public Service Commission,* Case No. 80-175-G-42T, is unreported. That decision is set forth in Appendix A.[1] The underlying order of the

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[1] **Materials included in the separately bound Appendix to this Petition will be cited as "App. ——."**

Public Service Commission of West Virginia is set forth in Appendix B.

JURISDICTION

The Order of the Supreme Court of Appeals of West Virginia denying Pennzoil's Petition for Appeal was entered on December 10, 1981. On January 11, 1982, Pennzoil filed with the Supreme Court of Appeals a Motion for Suspension of Time to Renew Petition for Appeal.[2] The Supreme Court of Appeals denied Pennzoil's motion on January 19, 1982. The order denying Pennzoil's motion is set forth in Appendix C.

Pennzoil invokes the jurisdiction of this Court pursuant to 28 U.S.C. § 1257(3).

STATUTES INVOLVED

The decision of the Supreme Court of Appeals affirmed an order of the Public Service Commission of West Virginia that interpreted Sections 2(21) and 602(a) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301(21) and 3432(a). The relevant portions of the NGPA are set forth in Appendix D.

STATEMENT OF THE CASE

A. Introduction.

Pennzoil seeks review of a decision of the Supreme Court of Appeals of West Virginia, which denied Pennzoil's appeal of an order of the West Virginia Public Service Commission. The order of the Public Service Commission adopts an interpretation of Section 2(21) of the NGPA, the definition of "first sale," that squarely conflicts with federal law; and purports to regulate the price of the "first sale" in interstate commerce of natural gas produced by Pennzoil, in violation of the powers delegated to the states by Congress in Section 602(a) of the NGPA.[3]

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[2] Pennzoil's motion was filed pursuant to Rule 7 of the West Virginia Rules of Appellate Procedure of the Supreme Court of Appeals, 21B Michie's Jurisprudence, Va. & W. Va. (1981 Supp.).

B. The Effect of the Natural Gas Policy Act.

In enacting the NGPA, Congress extended federal price ceilings to previously unregulated intrastate sales of natural gas, and thus fundamentally altered the division of responsibility among the federal government and the states regarding regulation of natural gas prices.[4] The key provisions by which Congress allocated that responsibility are the two sections of the NGPA at issue in this case. The first provision, the NGPA definition of "first sale," is the statutory concept developed by Congress to extend federal price controls to all gas produced in the United States. The second provision, Section 602(a) of the NGPA, defines the limited circumstances in which the states may override the maximum lawful prices established by the NGPA and may regulate "first sale" prices. The issues presented by this case will determine the means and scope of state regulation of natural gas prices under the NGPA.

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[3] Although the Commission's Order also decided other issues, Pennzoil sought judicial review only of the Commission's interpretations of the NGPA. If the Supreme Court of Appeals had reversed the Commission's interpretations of the NGPA, the Commission would have been compelled to grant the relief Pennzoil requested.

[4] *See generally* Oklahoma v. FERC, 494 F. Supp. 636 (W.D. Okla. 1980) *aff'd* 661 F.2d 832 (10th Cir. 1981), *petition for cert. filed*, 50 U.S.L.W. 3550 (U.S. Dec. 21, 1981) (No. 81-1232) (upholding the constitutionality of NGPA provisions extending federal price controls to intrastate sales of gas).

1. *The NGPA concept of "first sale."*

The NGPA establishes eight major categories of "maximum lawful prices."[5] Each maximum lawful price is applicable to "any first sale" of natural gas meeting the criteria prescribed in that category.[6] Because the pricing provisions of the Act apply to "any first sale," the definition of the term "first sale" determines the applicability of federal price regulation throughout the United States.

The Act includes a specific definition of the term "first sale."[7] Essentially, Congress intended the pricing provisions of the Act to apply to any sale of gas by the producer.[8] Accordingly, Congress excluded from the definition of "first sale" any sale "by an interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, *unless* such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof."[9]

In the NGPA, Congress delegated authority to the Federal Energy Regulatory Commission (FERC) to issue rules and to define further the terms used in the Act, subject to judicial review.[10] In an exercise of that authority, the FERC issued its Order No. 58,[11] setting forth its interpretation of when sales of gas produced by pipelines, distribution companies, or their affiliates would be deemed "first sales." In Order No. 58, the FERC focused on sales to end users, and interpreted the "first sale" definition to exclude sales in which gas produced by the pipeline or distribution company was mixed with gas purchased from other producers for resale. This interpretation would have prevented application of NGPA prices to almost all gas produced by pipelines and distribution companies.[12]

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[5] 15 U.S.C. §§ 3312-19.

[6] *Id.*

[7] 15 U.S.C. § 3301(21); App. D. Among other provisions, the definition includes sales "to any local distribution company"; "to any person for use by such person"; and any sale "which precedes any sale described in clauses (i), (ii), or (iii)."

[8] Mid-Louisiana Gas Co. v. FERC, 664 F.2d 530, 536 (1981) *reh'g denied,* —— F.2d —— (5th Cir. 1982). The Fifth Circuit's Opinion is set forth in full in App. E. *See also, e.g.,* Subchapter I of the NGPA, entitled "Wellhead Pricing."

[9] 15 U.S.C. § 3301(21)(b) (emphasis added).

On December 23, 1981, in *Mid-Louisiana Gas Co.* v. *Federal Energy Regulatory Commission,*[13] the United States Court of Appeals for the Fifth Circuit examined Section 2(21) of the NGPA and vacated FERC Order No. 58. The Fifth Circuit found the FERC's interpretation of the NGPA definition of "first sale" to be contrary to the intent of Congress, and held:

> Congress clearly intended for any production attributable to an "interstate pipeline, intrastate pipeline or local distribution company, or any affiliate thereof" to be accorded first sale status under the NGPA and . . . Congress contemplated that the intracorporate transfer of pipeline production to the pipeline would be treated as the first sale.[14]

The Fifth Circuit denied rehearing of its decision in *Mid-Louisiana* on February 5, 1982.

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[10] 15 U.S.C. § 3411.

[11] [Regulations Preambles 1977-1981 Transfer Binder] Fed. En. Reg. Comm. (CCH) ¶ 30,101, at 30,718 (Nov. 20, 1979).

[12] Id. at 30,719; *Mid-Louisiana Gas Co.,* 664 F.2d at 536.

[13] 664 F.2d 530 (1981) *reh'g denied,* —— F.2d —— (5th Cir. 1982); App. E.

[14] 664 F.2d at 538.

This case presents the issue of whether federal law governs interpretation of the term "first sale" or whether the states are free to adopt differing interpretations of that term as state law.

2. *The power delegated to the states under Section 602 of the NGPA.*

In extending federal controls to the intrastate market, Congress authorized one exception to the uniform application of NGPA "first sale" prices. In Section 602(a), Congress permitted the states to "establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under Subchapter I of [the NGPA]." [15]

The Conference Report includes the following explanation of Section 602(a):

> The conference agreement provides that nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for sales of gas in intrastate commerce which does not exceed the applicable maximum lawful price, if any, under Title I of this Act. This authority extends to the operation of any indefinite price escalator clause. The Congress enacts this provision with a recognition that it is ceding its authority under the commerce clause of the Constitution to regulate prices for such production to affected States. [16]

If a state has properly established maximum lawful prices pursuant to the authority granted by Section 602(a), then those prices govern sales of gas in intrastate commerce, and supplant the applicable NGPA prices. This case presents the issues of how the states may exercise their authority under Section 602(a), and what producer sales the states may regulate.

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[15] 15 U.S.C. § 3432(a). Section 602 is set forth in full in App. D.

[16] H.R. Rep. No. 1752, 95th Cong., 2d Sess. 124-25, *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 9041.

C. Facts.

The order of the Public Service Commission and the decision of the Supreme Court of Appeals arise from a request filed with the Commission by Pennzoil on May 1, 1980 seeking an increase in rates for retail sales to West Virginia customers. In that request, Pennzoil asserted the right to apply NGPA prices in calculating retail rates for certain volumes of gas produced by Pennzoil. The Commission denied the application of NGPA prices based on its interpretation of the provisions of the NGPA at issue in this case. The factual background of Pennzoil's operations and the proceedings below can be summarized briefly.

Pennzoil is a producer of oil and natural gas operating approximately 2,200 wells producing gas in West Virginia.[17] In West Virginia, Pennzoil also purchases and resells gas from approximately 140 other independent producers. To transport its own gas and gas purchased from other producers from the wellhead to interstate pipeline customers, Pennzoil operates a gas gathering system.[18] At any given time, approximately 60 percent of the gas in the gathering system has been produced by Pennzoil and approximately 40 percent has been purchased from independent producers close to Pennzoil's gathering lines. Incidental to its gathering activities, Pennzoil provides gas service to certain retail customers in West Virginia. Pennzoil performs this distribution-type service through a separate division, operating as the Utility Division of Pennzoil Company.[19]

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[17] Pennzoil also is a producer of natural gas in 15 other states.

[18] Pennzoil's transportation of gas in its gathering system is exempt from federal regulation pursuant to § 1(b) of the Natural Gas Act. 15 U.S.C. § 717(b).

On an average day, Pennzoil sells approximately 75 percent of the gas it transports in its gathering system to several interstate pipeline companies at various points of delivery within West Virginia. On the same average day, as a public service, the Utility Division sells the remaining 25 percent of the gas from the gathering system to small residential and commercial customers in West Virginia. The volumes sold to interstate and intrastate customers are not fixed by contract, however, and vary from day to day, depending on the requirements of the intrastate customers. Because the requirements of those customers change daily, depending on weather and other factors, the volumes of gas that will be sold to interstate and intrastate purchasers, respectively, are impossible to predict in advance.

Historically, Pennzoil's sales of gas to interstate pipelines have been subject to federal regulation under the Natural Gas Act as sales for resale in interstate commerce.[20] Since the passage of the Natural Gas Policy Act in 1978, Pennzoil's wellhead sales have been subject to the ceiling prices established by that statute. Pennzoil's retail sales of gas, through the Utility Division, to West Virginia customers are regulated by the state Public Service Commission.[21]

On May 1, 1980, Pennzoil filed with the Public Service Commission a revised tariff sheet seeking increased rates and charges for supplying gas to customers in West Virginia. As required by the Commission's regulations, Pennzoil's rate increase filing included evidence regarding various elements of the Company's cost of retail service.[22]

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[19] The gas sold to West Virginia customers by the Utility Division is transferred by formal accounting entries from Pennzoil's production and transportation facilities to the Utility Division's distribution facilities.

[20] 15 U.S.C. § 717(b).

[21] The Commission's powers and duties are set forth in W. Va. Code §§ 24-1-1 to 25-2-15.

The major component of Pennzoil's cost of service to West Virginia customers is its cost of "purchased gas," which includes both the actual cost of gas purchased from independent producers and the imputed "cost," or value, of gas produced by Pennzoil. Because the prices prescribed by the NGPA are applicable to Pennzoil's purchases from independent producers, Pennzoil calculated its cost of that gas based on the NGPA prices it actually paid. Similarly, in calculating the "cost" of gas produced from Pennzoil's own wells, Pennzoil assigned a value to its own produced gas equivalent to the applicable price prescribed by Congress in the NGPA.[23] In applying NGPA prices to its produced gas, Pennzoil concluded that a "first sale" occurred at one of three possible points: (a) at the point of transfer from Pennzoil's production facilities to its transportation facilities; (b) at the point of transfer from Pennzoil's transportation facilities to the distribution facilities of the Utility Division; or (c) at the point of sale to West Virginia customers.[24]

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[22] The Commission sets rates primarily on the basis of the cost of service, although other factors may be considered. W. Va. Code § 24-1-1(a)(4).

[23] The majority of Pennzoil's production in West Virginia qualifies for the prices provided by § 108 of the NGPA, 15 U.S.C. § 3318, and has been certified by the West Virginia Department of Mines as eligible for that price, pursuant to the procedures prescribed in § 503 of the NGPA, 15 U.S.C. § 3413, and W. Va. Code § 22-4-1a(c)(11).

[24] *See* 15 U.S.C. § 3301(21)(A)(ii), (iii) & (iv).

In proceedings before the Public Service Commission, the Commission Staff contested portions of Pennzoil's rate increase filing, including particularly the application of NGPA prices to Pennzoil's produced gas.[25] In briefs and argument before a Hearing Examiner, Pennzoil and the Commission Staff addressed the two issues in this case: (1) whether the intracorporate transfer or sale of Pennzoil's produced gas qualify as "first sales" to which the prices prescribed in the NGPA apply; and (2) whether the NGPA allows the West Virginia Public Service Commission to set a price lower than the applicable NGPA price for Pennzoil's produced gas.

The Hearing Examiner's Decision did not recognize any "first sale" of Pennzoil's produced gas.[26] Based primarily on his interpretation of the definition of "first sale" in Section 2(21) and FERC Order No. 58, the Hearing Examiner held that NGPA prices were not applicable to gas produced by Pennzoil and sold to West Virginia customers.[27] The Hearing Examiner concluded that, even if his interpretations of Section 2(21) and Order No. 58 were incorrect, "all other arguments now become academic" because, under Section 602 of the NGPA, "the State of West Virginia is authorized to set prices lower than NGPA prices, if it chooses to do so." [28] The Hearing Examiner concluded that, under Section 602, Congress "has left the determination of [Pennzoil's] prices within the jurisdiction of the Public Service Commission of West Virginia." [29]

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[25] In past proceedings, the Commission had calculated the cost of Pennzoil's produced gas, for ratemaking purposes, using a price established by the FERC and its predecessor, the FPC, as the applicable rate governing sales for resale in interstate commerce in West Virginia. The federal rate used in past cases was established originally in a 1976 FPC settlement order under the Natural Gas Act. *Independent Oil & Gas Assoc.*, "Order Accepting and Approving Settlement," 55 F.P.C. 1296 (1976).

[26] The Decision of the Hearing Examiner is set forth at Appendix F.

[27] Hearing Examiner's Decision at 12-15; App. F at 16f-21f.

[28] Hearing Examiner's Decision at 15; App. F at 21f.

On September 10, 1981, after briefing and argument by Pennzoil and the Commission Staff, the Public Service Commission issued an Order upholding the Hearing Examiner's interpretations of Sections 2(21) and 602 of the NGPA, denying application of NGPA prices to Pennzoil's produced gas, and arbitrarily setting the cost of Pennzoil's produced gas at the rate established by the FPC for interstate sales in West Virginia in 1976. The Commission discussed the NGPA definition of "first sale" in detail, and held:

> Pennzoil is a local distribution company with regard to its West Virginia retail customers. As such the comingling [sic] of its own produced gas with the gas that it purchases from others disqualifies the Company from claiming first sale treatment for the sales it makes from its general system supplies. The hearing examiner's determination that NGPA prices for Pennzoil's produced gas did not apply to the Company's sales to its retail customers in West Virginia is correct.[30]

The Commission further stated:

> Pennzoil's sales of its produced gas from its general system supply to its retail customers is the first time such gas is sold. Such amounts of gas are produced in this state, sold in this state and remain in Pennzoil's facilities for the entire gas transportation from the wellhead to the end user. Pennzoil would have the Commission apply first sale treatment to an intracorporate transaction.[31]

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[29] Hearing Examiner's Decision at 16; App. F at 22f.

[30] Order Modifying Hearing Examiner's Decision at 14; App. B at 21b.

[31] *Id.* at 15; App. B at 21b-22b.

Finally, the Commission found that "the hearing examiner's discussion of the 'first sale' requirement of the NGPA is sufficient legal ground upon which to find inappropriate Pennzoil Company's utilization of [the applicable NGPA price] as the lawful price for its produced gas.[32]

The Commission also discussed the Hearing Examiner's interpretation of Section 602 of the NGPA.[33] Apparently relying on the reasoning of the Hearing Examiner and rejecting Pennzoil's interpretation of Section 602, the Commission concluded:

> The Commission's authority and duty to establish the appropriate price for Pennzoil to include in its rates and charges for its own produced gas sold to its West Virginia retail customers has not been preempted by the NGPA, the NGA or the FERC, through its regulations and orders issued pursuant thereto.[34]

Relying on its general power to regulate utilities under the West Virginia Code, the Commission concluded that it had "jurisdiction to set just and reasonable rates primarily based on the cost that Pennzoil incurs in providing gas service to its retail customers in West Virginia." [35]

Subsequently, Pennzoil petitioned the Supreme Court of Appeals of West Virginia to review the Order of the Public Service Commission.[36] Pennzoil informed the court that the single issue in the case was whether the applicable NGPA price should be utilized for ratemaking purposes as the cost of Pennzoil's produced gas.[37] Pennzoil argued that the NGPA requires the Commission "to authorize collection of this federally-established rate" as part of the cost of Pennzoil's retail service.[38] The Commission responded that NGPA prices were not applicable to Pennzoil's produced gas, and that Chapter 24 of the West Virginia Code authorizes the Commission to exercise the wellhead pricing authority ceded to the State under Section 602 of the NGPA. The Commission quoted Section 602(a) of the NGPA, and stated:

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[32] *Id.*

[33] *Id.* at 3-7; App. B at 3b-10b.

[34] *Id.* at 17; App. B at 25b.

[35] *Id.* at 18; App. B at 25b.

[36] Pennzoil sought review in the Supreme Court of Appeals pursuant to W. Va. Code § 24-5-1.

> Thus, if for any reason the Court should reject the Commission's position that said Company production does not qualify as a 'first sale' under the NGPA, the Commission would submit that § 602(a) of the Act recognizes the Commission's proper exercise of its ratemaking authority.[39]

On December 10, 1981, after hearing argument, the Supreme Court of Appeals rendered its decision. The court stated that it had "maturely considered" Pennzoil's Petition and the entire record and had determined that Pennzoil had not "shown itself entitled to the relief prayed for in its said Petition." [40] Without further discussion or explanation, the court denied Pennzoil's Petition for Appeal.[41]

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[37] Petition for Appeal at 4-5. The pleadings filed below are not included in the Appendix to this Petition, but are part of the formal Record. Because the official Record has not yet been paginated or certified, the pleadings are cited directly.

[38] Petition for Appeal at 15.

[39] Statement of the Respondent at 12-13.

[40] Order at 1; App. A at 1a.

[41] *Id.* Pursuant to a motion by Pennzoil, the Supreme Court of Appeals subsequently stayed the order of the Public Service Commission pending Pennzoil's Petition to this Court for Certiorari. The Stay Order provides that the Public Service Commission may

Although the Supreme Court of Appeals did not state the grounds for its decision, the only issue before the court was whether the Commission was required to apply NGPA prices to Pennzoil's produced gas. Therefore, to uphold the Commission's order, the court must have relied either on the Commission's interpretation of the definition of "first sale" in Section 2(21), or on the Commission's interpretation of its authority under Section 602.

On December 23, 1981, the Fifth Circuit issued its decision in *Mid-Louisiana,* which interprets the NGPA definition of "first sale" in a way directly contrary to the order of the Public Service Commission, destroying the legal foundation of that order. To allow the Supreme Court of Appeals an opportunity to reconsider its denial of Pennzoil's appeal in light of the Fifth Circuit's Opinion, Pennzoil brought the *Mid-Louisiana* decision to the court's attention in a motion requesting further review.[42] On January 19, 1982 the Supreme Court of Appeals issued a final order denying Pennzoil's motion.

The Public Service Commission's order, affirmed by the Supreme Court of Appeals, is in direct conflict with the

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not enforce its decision until March 10, 1982, or until such time as Pennzoil's Petition to this Court is finally determined. The stay order is set forth at Appendix G.

[42] In response to Pennzoil's motion, the Commission stated:

> There is no provision under the NGPA or in the Fifth Circuit decision which would preclude the Commission, in exercising its responsibility as a substitute for the marketplace on behalf of the purchaser of gas, from establishing a rate *less than* the maximum lawful ceiling price. In fact, that is the Commission's obligation under Chapter 24 and that is what transpired in this case.
>
> Response at 7 (emphasis in original).

The Commission further argued that "the holding of the United States Court of Appeals is not binding on this Court." *Id.*

interpretation of the NGPA definition of "first sale" adopted by the Fifth Circuit in *Mid-Louisiana*. In addition, the Public Service Commission and the Supreme Court of Appeals have incorrectly interpreted Section 602(a) of the NGPA, and the Commission has exceeded the authority delegated in that section by Congress. Pennzoil respectfully files this Petition for a Writ of Certiorari to obtain review of West Virginia's interpretation of these two important provisions of the NGPA.

REASONS FOR GRANTING THE WRIT

Pennzoil seeks a Writ of Certiorari in order that this Court may resolve two substantial questions of federal law. Both questions are of nationwide impact and significance in establishing the dividing line between federal and state authority in regulating sales of natural gas.

Put most simply, the first question is whether West Virginia or the Fifth Circuit is correct in its interpretation of the definition of "first sale" in Section 2(21) of the NGPA. The Public Service Commission has adopted as state law the interpretation of the term "first sale" in FERC Order No. 58, despite the fact that the Fifth Circuit has vacated Order No. 58 in its entirety and has expressly held FERC's interpretation of the term "first sale" to be contrary to the intent of Congress.

Assuming that Pennzoil's produced gas is entitled to "first sale" treatment under the NGPA, the second question is whether the Public Service Commission has authority to set wellhead prices for Pennzoil's produced gas under Section 602(a) of the NGPA.[43] Pennzoil asserts that only a state legislature may exercise the authority granted under Section 602.

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[43] Encompassed within the second question are two subsidiary questions: (1) whether § 602 authorizes the states to establish maxi-

I.

THE "FIRST SALE" QUESTION

A. The Decision Of The West Virginia Supreme Court Is In Direct Conflict With The Fifth Circuit.

In *Mid-Louisiana,* the Fifth Circuit held that an intracorporate transfer from a company's production facilities to its transportation facilities constitutes a "first sale" under Section 2(21) of the NGPA. The Public Service Commission and the Supreme Court of Appeals have taken the position that the Fifth Circuit's decision does not bind them, and interpret the NGPA definition of "first sale" in exactly the way the Fifth Circuit held contrary to the intent of Congress.[44]

After the Fifth Circuit's decision in *Mid-Louisiana,* Pennzoil requested the Supreme Court of Appeals to reconsider its decision. The court denied Pennzoil's request. Thus, the Supreme Court of Appeals has ignored the express holding of the Fifth Circuit and has upheld as state law the Public Service Commission's adoption of the FERC interpretation of "first sale" vacated in *Mid-Louisiana.*

Pennzoil submits that the conflict between the West Virginia Supreme Court and the Fifth Circuit regarding this

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mum lawful prices on a case-by-case basis, or whether such prices may only be established by generally applicable legislation or rules issued pursuant to properly delegated authority; and (2) whether § 602 authorizes the states to establish maximum prices for "first sales" occurring in interstate commerce.

[44] *Compare* the holding of *Mid-Louisiana,* 664 F.2d at 538, with the holding of the Commission's Order at 14-15; App. B at 21b-22b.

important question provides sufficient reason to grant a writ of certiorari in this case.[45]

B. West Virginia Has No Power To Adopt An Interpretation Of The Term "First Sale" That Conflicts With Federal Law.

Neither the Public Service Commission nor the Supreme Court of Appeals has the power to interpret the NGPA definition of "first sale" in a way that conflicts with the Fifth Circuit's interpretation. The power of the states to interpret the NGPA is preempted by federal law to the extent that the state interpretation directly conflicts with the language of the statute, an interpretation by the FERC, or a court interpretation on judicial review of a FERC order. If the interpretation upheld by the Supreme Court of Appeals is allowed to stand, every state will be free to interpret the fundamental concept of "first sale" according to its own state law, creating the possibility of fifty different theories of the applicability of the NGPA.

In Section 501 of the NGPA,[46] Congress delegated to the FERC exclusive authority to administer the NGPA and to define the terms used in that Act. The Conference Report states that Congress provided the FERC with "authority to refine definitions of terms provided in the Act in a manner that is consistent with the definitions provided."[47] The Report further states that the Commission may "establish rules applicable to intracorporate transactions under the first sale definition."[48]

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[45] *See* Sup. Ct. R. 17.1(b).

[46] 15 U.S.C. § 3411.

[47] H.R. Rep. No. 1752, 95th Cong., 2d Sess. 69, *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 8985.

[48] H.R. Rep. No. 1752, 95th Cong., 2d Sess. 116 *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 9033.

Congress also provided, in Section 506, that an aggrieved party may obtain judicial review of any exercise of the FERC's rulemaking authority exclusively in the United States Courts of Appeals.[49] Thus, if an interpretation issued by the FERC is affirmed or modified on judicial review, the decision of the court of appeals establishes federal law preempting any inconsistent interpretation of the federal statute by state administrative agencies or courts.[50]

In this case, the Fifth Circuit vacated the FERC's interpretation of the term "first sale," and established its own interpretation, implementing its understanding of the intent of Congress. The Fifth Circuit's interpretation in *Mid-Louisiana* is now federal law, unless modified by this Court on certiorari.[51] Although the Fifth Circuit's decision is not binding on federal courts in other circuits, it preempts any inconsistent interpretation at the state level.[52]

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[49] 15 U.S.C. § 3416(a)(4).

[50] Pennzoil Co. v. FERC, 645 F.2d 360, 385-87 (5th Cir. 1981), *cert. denied,* 50 U.S.L.W. 3547 (U.S. Jan. 11, 1982) (No. 81-340) (recognizing possible preemption of state law by federal common law "when the issues involve so strong a federal interest that it is appropriate to resolve them on the basis of uniform decisional federal law rather than varying state laws"). *See* California v. Southland Royalty Co., 436 U.S. 519 (1978) (holding that federal interests under Natural Gas Act override state property law on issue of dedication to interstate commerce); United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392, 400 (1965) (finding proper interpretation of term "sale" under Natural Gas Act must be determined pursuant to federal law and not state law).

[51] The Fifth Circuit denied petitions for rehearing in *Mid-Louisiana* on Feb. 5, 1982. Thus, pursuant to 28 U.S.C. § 2101, the time for filing petitions for certiorari in that case will expire on May 6, 1982.

[52] *See* note 50, *supra.*

Even if the Fifth Circuit were incorrect in *Mid-Louisiana,* the Public Service Commission's interpretation of the term "first sale" still would conflict with the plain language of the definition of that term in the NGPA. At some point in the movement of Pennzoil's produced gas from the wellhead to West Virginia retail customers, a "first sale" within the intent of Congress must occur. Whether the "first sale" occurs at the point of transfer from production to transportation, at the point of transfer from transportation to distribution, or at the point of final sale to the end user, the pricing provisions of the NGPA apply. The Public Service Commission and the Supreme Court of Appeals of West Virginia have disregarded the congressional intent behind the plain language of the NGPA definition of "first sale." Instead, they have attempted to enforce, as state law, a conflicting interpretation that would preclude any application of the NGPA by defining the term in such a way that no "first sale" of Pennzoil's produced gas would ever be deemed to occur.

C. The Consequences Of The West Virginia Decision.

Unless the interpretation of "first sale" adopted by the Public Service Commission and upheld by the Supreme Court of Appeals is reversed, the procedures established by Congress for orderly administration of the wellhead pricing provisions of the NGPA will have been bypassed, with the consequence that each state will be free to interpret the terms used in the NGPA as it pleases. Interpretation of the term "first sale" is particularly significant, since it determines the applicability of all of the wellhead pricing provisions of the NGPA.

The dangers of allowing the states to develop conflicting interpretations of the terms and applicability of the NGPA are manifest. The compromise enacted in the NGPA was specifically designed to put an end to geographical distinctions in natural gas pricing, and to substitute a uniform pricing system applicable to "the 'first sale' of any natural gas" in the United States.[53] Inconsistent interpretations of the definition of "first sale," varying by state or by region, would seriously undermine the congressional goal of establishing a unified national market for natural gas. Pennzoil submits that review by this Court on certiorari is essential to ensure a uniform, nationwide interpretation of the fundamental NGPA concept of "first sale."

II.

THE QUESTION OF STATE AUTHORITY

Under the Fifth Circuit's decision in *Mid-Louisiana,* or under an independent analysis of the plain language of the NGPA, it is apparent that a "first sale" of Pennzoil's produced gas takes place at some point in the chain of events from the wellhead to the end user. The remaining question is whether the Public Service Commission has the authority to refuse to recognize the NGPA price applicable at the point of the "first sale" and to set its own wellhead price for Pennzoil's produced gas. The Commission asserts that Section 602(a) of the NGPA authorizes it to set maximum lawful prices for "first sales" of gas produced in West Virginia. Pennzoil submits that the Supreme Court of Appeals and the Public Service Commission have interpreted Section 602(a) incorrectly, and that the Commission has exceeded the authority delegated to the states by Congress.

The Commission has exceeded its authority in three ways. First, the authority delegated under Section 602(a) only allows the states to establish maximum lawful prices for sales of gas in intrastate commerce. In this case, the "first sale" of Pennzoil's produced gas takes place in *interstate* commerce, and is beyond the regulatory power of the State. Second, under Section 602(a), only the Legislature, and not the Public Service Commission, has the authority to establish maximum lawful prices for wellhead sales. In this case, the Legislature has neither exercised that power nor delegated that power to the Public Service Commission. Third, the authority under Section 602(a) to establish a "maximum lawful price" for "first sales" of natural gas may not be exercised on a case-by-case basis. Rather, it may only be exercised through the enactment of legislation or through the establishment, pursuant to properly delegated authority, of general rules applicable to all wellhead sales in the state.

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[53] H.R. Rep. No. 1752, 95th Cong., 2d Sess. 74 *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 8991; 15 U.S.C. § 3311(b)(4)(A).

A. Pennzoil's First Sale Is Not In Intrastate Commerce.

Under Section 602(a), the states only have power to establish maximum lawful prices for sales "in intrastate commerce."[54] As established by the Fifth Circuit in *Mid-Louisiana,* the "first sale" of Pennzoil's produced gas takes place at or near the wellhead, when that gas is transferred from Pennzoil's production facilities to its transportation or distribution facilities. In this case, the "first sale" of Pennzoil's gas takes place in "interstate" and not "intrastate" commerce.

The majority of Pennzoil's produced gas is sold to interstate pipelines for resale in interstate commerce, while the remaining produced gas is sold to West Virginia customers. At the point of the "first sale," gas destined for interstate commerce is commingled with gas that ultimately will be sold in West Virginia, and it is therefore impossible to determine which molecules of gas ultimately will flow to particular interstate or intrastate customers. Prior decisions of this Court and lower courts regarding the effects of commingling gas destined for interstate customers with gas destined for intrastate customers establish beyond doubt that the "first sale" of the entire volume of Pennzoil's produced gas takes place "in interstate commerce." [55]

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[54] H.R. Rep. No. 1752, 95th Cong., 2d Sess. 124 *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 9041.

Under Pennzoil's contracts for sale of gas to interstate pipelines, and pursuant to certificates granted by the FERC under the Natural Gas Act, all of Pennzoil's produced gas in West Virginia is "dedicated" to those interstate pipelines. The FERC has held that all of Pennzoil's produced gas in West Virginia originally was dedicated to, and could only be sold in, interstate commerce, but has modified one of Pennzoil's certificates to allow Pennzoil to "abandon" certain sales in interstate commerce solely to the extent necessary to serve the varying requirements of its then-existing West Virginia retail customers.[56] Thus, until gas is actually delivered to a retail customer, pursuant to the terms of the FERC abandonment order, all of the gas remains "in interstate commerce." [57]

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[55] California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965); FPC v. Amerada Petroleum Corp., 379 U.S. 687 (1965); Louisiana Public Service Comm'n v. FPC, 359 F.2d 525 (5th Cir.), *cert. denied,* 385 U.S. 833 (1966); Deep South Oil Co. v. FPC, 247 F.2d 882 (5th Cir. 1957), *cert. denied* 355 U.S. 930 (1958). The decision in *Deep South* is particularly relevant, because the fact situation there is very similar to the fact situation in this case.

[56] *Pennzoil Co.,* FERC Docket No. G-7004, "Finding and Order After Statutory Hearing Permitting and Approving Abandonment of Service" (Nov. 24, 1980). The full text of this Order is set forth in Appendix H.

[57] *See, e.g.,* United Gas Pipe Line Co. v. McCombs, 442 U.S. 529 (1979).

Because the "first sale" of Pennzoil's produced gas is in "interstate" and not "intrastate" commerce, the Public Service Commission has no power under Section 602(a) to set a maximum lawful price for that sale. Instead, the "first sale" price is established by the NGPA. In setting utility rates for Pennzoil's retail sales to West Virginia customers, the Public Service Commission is obligated by federal law to recognize the applicable NGPA price as the "cost" of Pennzoil's produced gas.[58]

B. The West Virginia Legislature Has Not Exercised Its Authority Under Section 602.

Even if the "first sale" of Pennzoil's produced gas were deemed to be in intrastate commerce, the Public Service Commission still would have no power to set the price of that transaction. Section 602(a) provides that the NGPA does not preempt state laws permitting regulation of maximum lawful prices for "first sales" in intrastate commerce. It does not, however, expand the existing powers of the states, and is not an independent source of authority to regulate wellhead prices. In West Virginia, the Public Service Commission had no power to regulate wellhead sales by producers before the NGPA,[59] and it has no power to regulate those sales now.

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[58] *Mid-Louisiana,* 664 F.2d at 537.

[59] Under West Virginia law, the Public Service Commission never has had the power to regulate producer sales of natural gas at the wellhead. *Cf.* Eureka Pipe Line Co. v. Public Service Comm'n, 148 W. Va. 674, 684; 137 S.E.2d 200, 206 (W. Va. 1964) (holding no power to regulate oil production or marketing). The jurisdiction of the Public Service Commission with respect to natural gas extends only to utilities engaged in "transportation of . . . gas . . . by pipeline [and] . . . supplying . . . gas . . . by municipalities or others." W. Va. Code § 24-2-1. In its function as a producer of natural gas, Pennzoil Company is not a public utility. The

In Section 602(a), Congress ceded its power to regulate prices for first sales in intrastate commerce to the "States" and not to state agencies. The NGPA contains a precise definition of the term "State", which does not include any reference to state agencies.[60] In other sections of the NGPA, Congress delegated powers to state jurisdictional agencies by explicitly referring to the agency itself, and not by using the term "State." In view of the NGPA's specific definition of the term "State," the delegation of authority in Section 602(a) must be viewed as a delegation to state legislatures rather than to state agencies. Therefore, the Public Service Commission has no power to implement Section 602(a) unless that power has been properly delegated to the Commission by the West Virginia Legislature.

The West Virginia Legislature has not enacted any statute establishing maximum lawful prices for "first sales" in intrastate commerce. Further, the Legislature has not delegated any authority to the Public Service Commission to regulate wellhead sales under Section 602(a) of the NGPA.[61] Thus, in this case, the Commission's regulation of Pennzoil's "first sale" price exceeds the authority dele-

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Commission's jurisdiction extends only to the sale of gas by Pennzoil's Utility Division to West Virginia customers.

[60] The NGPA defines the term "state" as "each of the several States and the District of Columbia." 15 U.S.C. § 3301(34).

[61] The Legislature has stated that "the commission shall carry out other federal acts, including appropriate portions of the 'Natural Gas Policy Act of 1978,' for which the governor designates it as the responsible agency in this State." W. Va. Code § 24-2-13. That provision does not expand the Commission's existing jurisdiction, which does not extend to regulation of wellhead prices. In addition, the Governor of West Virginia has not designated the Public Service Commission as the responsible agency for any purposes under the NGPA.

gated by Congress under Section 602(a) and violates the NGPA's allocation of powers between the federal and state governments.

C. Section 602 Precludes Establishment Of Rates On A Case-By-Case Basis.

Finally, even if it is deemed to have authority to set wellhead prices, the Public Service Commission has no power under Section 602(a) of the NGPA to regulate the "first sale" price for Pennzoil's produced gas on a case-by-case basis in a retail rate proceeding. If Congress had intended to allow the states to set "first sale" prices in individual cases, using a cost-of-service methodology, it would have expressly provided that the states could set "just and reasonable" prices.

In Section 602(a) of the NGPA, Congress authorized the states "to establish or enforce any maximum lawful price for the first sale of natural gas." [62] Previously, under the Natural Gas Act, the FERC established "just and reasonable" prices for sales of natural gas in interstate commerce relying primarily on a cost-of-service ratemaking methodology. The NGPA concept of "maximum lawful price" was intended to replace the concept of "just and reasonable" prices that had existed under the Natural Gas Act.[63]

In the NGPA, Congress put an end to cost-of-service ratemaking at the federal level by establishing categories of uniform "maximum lawful prices" applicable to all "first sales" of gas in the United States. Thus, when it used the term "maximum lawful price" in Section 602(a), Congress intended only to authorize the states to establish generally applicable categories of ceiling prices for "first sales" in intrastate commerce.[64] In West Virginia, the Legislature may enact a statutory plan of uniform maximum lawful prices under the authority of Section 602(a), or it may, by statute, delegate to the Public Service Commission the authority to establish uniform lawful prices by regulation. In no circumstance, however, does the Commission have the power to implement Section 602(a) on a case-by-case basis, effectively setting wellhead prices only for those producers who also function as public utilities.

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[62] 15 U.S.C. § 3432(a).

[63] See generally *Note, Legislative History of the Natural Gas Policy Act: Title I*, 59 Tex. L. Rev. 101, 106-21 (1980) for an explanation of the cost-based "just and reasonable" ratemakng methodology under the Natural Gas Act and a comparison with the system of maximum lawful prices established by the NGPA.

The only logical construction of Section 602(a) is that Congress intended to allow the states to establish uniform ceiling prices by statute. When it enacted Section 602(a), Congress must have been aware of the existence of the New Mexico Natural Gas Pricing Act, which had been enacted by the New Mexico Legislature in 1977.[65] In that statute, New Mexico established a ceiling price for all sales of gas produced in New Mexico and sold in intrastate commerce, subject to certain limitations and escalations.[66] Since the effective date of Section 602, two states have joined New Mexico in enacting statutes establishing maximum lawful prices for sales in intrastate commerce.[67] The outcome of this case will determine the manner in which the remaining 47 states implement Section 602.

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[64] Congress used the term "maximum lawful price" throughout the NGPA when referring to the general categories of prices applicable to all "first sales" of gas.

[65] N.M. Stat. Ann., §§ 62-7-1 to 62-7-10 (1978). Senator Domenici of New Mexico was one of the nine Managers of the Conference on the NGPA on the part of the Senate.

[66] *See* Hecht Co. v. Southern Union Co., 474 F. Supp. 1022, 1029-30 (D.N.M. 1979).

D. Potential Consequences Of The Commission's Assertion Of Authority.

The Commission's assertion of authority to set wellhead prices under Section 602(a) is totally unfounded, and the decision of the Supreme Court of Appeals upholding the Commission's action is in error. Unless this error is corrected, the purposes of the NGPA will be seriously undermined. In addition, the Commission's usurpation of authority to set wellhead prices under Section 602(a) will have significant practical consequences for all producers of natural gas in West Virginia and in other states that eventually follow West Virginia's example.

The interpretation of Section 602(a) adopted by the Public Service Commission would allow state public service commissions to regulate wellhead gas prices without authorization from their state legislatures. Nothing in the provisions or history of the NGPA suggests in any way that Congress intended Section 602(a) to authorize state commissions to regulate wellhead prices without state statutory authorization. In addition, if state public service commissions may establish the maximum lawful prices referred to in Section 602(a) on a case-by-case, cost-of-service basis, there will be as many "maximum lawful prices" as there are wells within the state. Production from each well could receive a different cost-based price, depending on the particular circumstances of that well.

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[67] Kansas Natural Gas Price Protection Act, Kan. Stat. Ann. §§ 55-1401 to 1415 (Supp. 1980); Oklahoma Natural Gas Price Protection Act, 52 Okla. Stat. Ann. §§ 260.1 to 260.13 (Supp. 1980). The legislative history of the Kansas Act specifically references the authority granted to the states by the NGPA. Committee Report on H.B. 2680, Kansas Journal of the House at 962 (1979).

The burden of case-by-case regulation of "first sales" in intrastate commerce in West Virginia alone would be enormous. In West Virginia, there presently exist more than 40,000 producing oil and gas wells from which sales of gas are or may someday be made within the state. In addition to the regulatory burden the Commission's interpretation would impose on West Virginia producers, the Commission itself would be faced with the immense task of conducting cost-of-service rate proceedings for every individual producer sale and establishing a "maximum lawful rate" for each of those sales. Every producer rate decision would be subject to judicial review.

In summary, the interpretation adopted by the Public Service Commission and upheld by the Supreme Court of Appeals would begin the same type of revolution in natural gas price regulation in the states that this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*[68] began at the federal level. In view of the long experience, and extreme difficulty, of the Federal Power Commission in implementing the *Phillips* decision through case-by-case producer price regulation,[69] and in view of the fact that one of the purposes of the NGPA was to relieve that difficulty by eliminating cost-based regulation of producer prices, the Public Service Commission's interpretation requiring case-by-case, cost-of-service regulation of "first sales" is contrary to the intent of Congress in Section 602(a), and should be struck down.

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[68] 347 U.S. 672 (1954).

[69] *See In re* Permian Basin Area Rate Cases, 390 U.S. 747, 755-58 (1968).

CONCLUSION

The questions presented by this case are of national importance, affecting every producer who sells gas in intrastate commerce, as well as many who sell gas in interstate commerce; and affecting the powers and duties of every state legislature and state regulatory commission. Unless this Court resolves the questions presented, the applicability of the NGPA to thousands of transactions nationwide will be uncertain. Therefore, Pennzoil respectfully requests this Court to grant a Writ of Certiorari.

Respectfully submitted,

/s/ BRUCE F. KIELY

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Dated: March 10, 1982

CERTIFICATE OF SERVICE

I hereby certify that I have served three copies of this Petition for a Writ of Certiorari on:

Robert R. Rodecker
General Counsel
Public Service Commission of
West Virginia
State Capitol
Charleston, West Virginia 25305

who is the only party required to be served, by first class mail, postage prepaid, this 10th day of March 1982.

/s/ KIRK K. VAN TINE

KIRK K. VAN TINE
Attorney for
PENNZOIL COMPANY

Appendix

81-1672

No. 81-

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

PENNZOIL COMPANY,
Petitioner,
v.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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No. 81-

PENNZOIL COMPANY,
Petitioner,
v.
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

TABLE OF CONTENTS
TO
APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

APPENDIX A: Order of Supreme Court of Appeals, State of West Virginia

APPENDIX B: Order Modifying Hearing Examiner's Decision

APPENDIX C: Order of Supreme Court of Appeals, State of West Virginia

APPENDIX D: Statutes

APPENDIX E: *Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530 (1981) *reh'g denied*, —— F.2d —— (5th Cir. 1982)

APPENDIX F: Hearing Examiner's Decision

APPENDIX G: Stay of Public Service Commission Order

APPENDIX H: Finding and Order After Statutory Hearing Permitting and Approving Abandonment of Service

APPENDIX A

SUPREME COURT OF APPEALS
STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 10th day of December, 1981, the following order was made and entered, to-wit:

PENNZOIL COMPANY, a Corporation

vs.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

Upon an appeal from, suspension and review of the final order of the Public Service Commission of West Virginia made and entered on September 10, 1981.

The Court having maturely considered the petition; the record consisting of all papers, documents and evidence which were before the Public Service Commission at the hearing which resulted in the entry of the final order complained of; the statement of reasons for the entry of its order of the 10th day of September, 1981, filed herein by the respondent, Public Service Commission of West Virginia on October 30, 1981; and the oral argument of counsel on the 3d day of November 1981, the date fixed by the Court for hearing upon the aforesaid petition; is of opinion that the petitioner has not shown itself entitled to the relief prayed for in its said petition. It is therefore considered and ordered that the prayer of the petition for an appeal from, suspension and review, in this proceeding, be, and the same is hereby denied.

It is further ordered that leave be, and the same is hereby granted to the Public Service Commission of West Virginia to withdraw from the office of the Clerk of this Court, the record consisting of all papers, documents and evidence originally filed with the Public Service Commission of West Virginia.

A True Copy

Attest: /s/ George W. Singleton
Clerk Supreme Court of Appeals

APPENDIX B

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, at the Capitol in the City of Charleston on the 10th day of September, 1981.

Case No. 80-175-G-42T

PENNZOIL COMPANY, a corporation,
Vienna, Wood County.
In the matter of increased rates and charges.

ORDER MODIFYING HEARING EXAMINER'S DECISION

Procedure

On the 17th day of February, 1981, a hearing examiner entered a recommended decision in the above styled and numbered case granting the Pennzoil Company ("Pennzoil" or "Company") an increase in rates of about $231,000 of the $1,653,705 sought by the utility.

On March 4, 1981, Pennzoil filed exceptions to the above mentioned recommended decision alleging that such was contrary to the evidence presented in the case, was arbitrary and based upon a misapplication of legal principles. Specifically, Pennzoil excepted to that portion of the hearing examiner's decision containing findings and conclusions which allegedly deprive it of the proper treatment of its cost for its own produced gas.

Oral argument on the matters raised in the exceptions filed by the company was held in the Commission's hearing room at the Capitol, Charleston, West Virginia, on the

28th day of April, 1981. C. E. Goodwin and Patricia A. Curran, attorneys at law, appeared on behalf of the Pennzoil Company. Robert R. Rodecker appeared on behalf of the Commission's Legal Division. At the close of the hearing the case was submitted for decision.

Discussion and Comments

A. *The Hearing Examiner's Decision*

The hearing examiner determined that $1.3945 per Mcf
was the appropriate rate for Pennzoil to price its own pro-
duced gas for inclusion in the rates it charges to its retail
2 customers in West Virginia.[1] ⊥ The record contains sev-
eral recommendations with regard to the appropriate price
for the Company's produced gas sold to consumers in West
Virginia. In its Rule 42 Exhibit Pennzoil used the price of
$3.31 per Mcf which represented a weighted average rate
for gas sold by Pennzoil to others calculated in accordance
with the appropriate provisions of the Natural Gas Policy
Act of 1978 (NGPA or Act).[2] (Respondent's Exhibit
RS-1, Company Rule 42). In compliance with the Com-
mission's order in Case No. 79-145-G-42T, Pennzoil made

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[1] Although the examiner, on page 16 of his decision, stated that he added the gathering cost of 61 cents to the $1.3945, the appendices attached to the order and the language used in the ordering section do not include the 61 cent gathering charge a second time. The $1.3945 already includes the gathering charge of 61 cents together with a production cost of 67.85 cents and a B&O tax of 10.6 cents. Appendix A attached to the hearing examiner's decision also failed to include $422,758 in the Company's operation and maintenance expenses to reflect its cost of purchased gas. Such amount has been included in the O&M expenses in Appendix A, attached hereto.

[2] Public Law 95-621, enacted November 9, 1978.

available to the Commission Staff what it represented to be an actual expense-based study determining the cost of its natural gas production and gathering functions, but did not choose to introduce it as evidence in this case by sponsoring it as an evidentiary exhibit. Such study calculated a cost of $4.69 per Mcf for Pennzoil's produced gas. The study was entered of record as Staff Exhibit No. 4; however, the hearing examiner found, and the Commission agrees, that such exhibit was without a competent sponsoring witness to testifying [sic] regarding its identification, authenticity and accuracy and thus, was incompetent as evidence.

Commission Staff utilized three models in its testimony on this issue (Staff Exhibit No. 3). Such models consisted of:

1. An "IOGA rate" calculation of $1.3945—which included a gathering cost of 61 cents, a production cost of 67.85 cents and a B&O tax of 10.6 cents.

2. A unit cost figure of $2.4890—which included a gathering cost of 61 cents, a production cost of $1.6810 (which reflects Pennzoil's weighted average purchased gas cost for the seven months ending July 31, 1980), and a B&O tax of 19.8 cents.

3. A cost of service figure of $2.7470—which included a gathering cost of 61 cents per Mcf, a production cost of $1.9190 (developed from Pennzoil's production and gathering cost study made available to and adjusted by Commission Staff but not entered of record by the Company), and a B&O tax of 21.8 cents.

In concluding that $1.3945 was the appropriate price to be placed on Pennzoil's produced gas, the hearing examiner discussed the "first sale" requirements of the NGPA as contained in § (2)21 of the table of ⊥ contents of said 3

Act[3] together with a portion of the final regulations issued by the FERC.[4] The examiner further discussed § 105(b)[5] and § 101(b)(9)[6] of Title I and § 601(b)(1) of Title VI of the NGPA together with the September 23, 1980 and December 10, 1980 FERC administrative law judge's decisions in consolidated docket RI74-188 and 75-21 (which found that the pricing mechanism for old gas was to apply the appropriate area rate adjusted for inflation), in concluding that Pennzoil had failed to show contractual entitlement to NGPA rates.

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[3] (21) Section 2—Definitions

First sale—(A) General Rule—The term "first sale" means any sale of any volume of natural gas—

- (i) to any interstate pipeline or intrastate pipeline;
- (ii) to any local distribution company;
- (iii) to any person for use by such person;
- (iv) which precedes any sale described in clauses (i), (ii) or (iii): and
- (v) which precedes or follows any sale described in clauses (i), (ii), (iii) or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act.
- (B) Certain sales not included—clauses (i), (ii), (iii) or (iv) of sub-paragraph (A) shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline or local distribution company or any affiliate thereof.

[4] See FERC Order No. 58, 44 F.R. 66577 (November 14, 1979) and FERC Order No. 102, 45 F.R. 67083 (October 3, 1980).

[5] Section 105—Ceiling price for sales under existing intrastate contracts

(b) Maximum Lawful Price—

- (1) General rule—subjects to paragraphs (2) and (3), the maximum lawful price under this section shall be the lower of—
  - (A) The price under the terms of the existing contract, to which such natural gas was subject on the day of the enactment of this act, as such contract was in effect on such date; or
  - (B) The maximum lawful price, per million Btu's computed for such month under § 102 (relating to new natural gas).

In closing his discussion of the applicability of the Natural Gas Policy Act of 1978 to Pennzoil's pricing of its own produced gas, the hearing examiner noted that § 602 of Title VI of the NGPA authorized the several states to prescribe lower maximum lawful prices than those set by the Congress in the NGPA.[7]

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[6] Section 101—Inflation adjustment; other general price ceiling rules.

(b) Rules of General Application

(9) Effect on contract price—in the case of—

(A) Any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this title; or

(B) Any price which is established under any contract for the first sale of natural gas which is exempted under subtitle B of this title from the application of a maximum lawful price under this title. Such maximum lawful price, or such exemption from such a maximum lawful price, shall not supercede or nullify the effectiveness of the price established under such contract.

[7] Section 602—Effect on state laws

(a) Authority to prescribe lower maximum lawful prices—

Nothing in this act shall affect the authority of any state to establish or enforce any maximum lawful price for the first sale of natural gas produced in such state which does not exceed the applicable maximum lawful price, if any, under Title I of this act.

4 The examiner was of the opinion that whether or not one adopted his aforementioned arguments, that the State of West Virginia was authorized to set retail gas prices lower than NGPA prices if it so chose to do so, quoting a portion of W.Va. Code § 24-1-1(a)[8] and citing to other portions of the W.Va. Code giving the Commission authority over the practices and rates of the Pennzoil Company[9] to support his conclusion that the Commission has the duty, the authority and the responsibility to set rates as closely as possible to the actual cost of providing gas service to West Virginia consumers.

B. *Pennzoil's Exceptions to the Hearing Examiner's Decision*

In its exceptions filed on March 4, 1981, Pennzoil (Respondent) contended; (1) that the lowest rate supported by record evidence for Pennzoil's produced gas is $2.4890; (2) that the Commission has historically authorized Pennzoil to price its own production at the applicable area rate (IOGA price) paid to West Virginia's small producers which is now no longer the applicable area rate; (3) that the hearing examiner was in error in concluding that the only contractually permissible rate is the IOGA rate; (4) that should the Commission ignore the required NGPA rate of $3.31 per Mcf for Pennzoil's produced gas, the effect would not reduce such cost below $2.4890; and (5) that the provisions of W.Va. Code § 24-1-1(a)(4) do not permit the establishment of a rate less than $2.4890. Respondent further stated that assuming the Commission were authorized to set a rate for its produced gas sold in its utility market lower than its proposed NGPA rate, Chapter 24 of the W.Va. Code does not permit the Commission to arbitrarily set whatever rate it may choose. Pennzoil asserts that the Commission is not authorized to set confiscatory or discriminatory rates nor does it have the authority to prescribe rates which are not just and reasonable but has the duty to set rates of public utilities "based primarily on the costs of providing these services".[10]

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[8] "It is the purpose and policy of the Legislature . . . to confer upon the Public Service Commission of this State the authority and duty to enforce and regulate the practices, services and rates of public utilities in order to . . . (4) Ensure that rates and charges for utility services are just, reasonable, applied without unjust discrimination or preference and based primarily on the cost of providing these services. . ."

[9] W.Va. Code § 24-2-1, § 24-2-2, § 24-2-3, § 24-2-4 and § 24-2-7.

C. *Oral Argument* 5

1. *Pennzoil*

During oral argument in this case Pennzoil addressed the three major barriers discussed in the hearing examiner's decision which would prevent the Company from collecting NGPA rates for its own produced gas. The examiner's reasoning that NGPA rates do not apply in this instance is premised on the following conclusions: (1) that Pennzoil's produced gas does not qualify as a first sale as required by the NGPA and FERC Regulations and orders,[11] (2) Pennzoil does not have a contract to purchase self-produced gas containing language of entitlement to NGPA rates, and (3) that § 602 of Title VI of the NGPA empowers states to prescribe rates lower than the maximum lawful prices set out in the NGPA.

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[10] W.Va. Code § 24-1-1(a)(4), p. 14 of the Company's Exceptions.

[11] NGPA Section 2(21), FERC Regulation § 270.203(A) and (B), FERC Order No. 58, and FERC Order No. 102.

[12] Section 270.203 Pipeline Distribtuor and Affiliate Production, (a) Attribution Rule for Pipelines and Distributors.

Pennzoil argued that since it is primarily a gatherer and producer of natural gas it is not a pipeline nor a distribution company as defined in Section 2(17) of the NGPA. Thus, it argues, its sales to its utility customers are first sales and NGPA prices apply to the gas it produces in West Virginia. The Company interprets Section 2(21)(ii) of the NGPA to regulate its sales of gas to its West Virginia retail customers. Based upon its classification of itself as a producer and not as a pipeline or a distribution company, Pennzoil contends that FERC Regulation Section 270.203 and the FERC orders issued pursuant thereto[13] are inapplicable to the Company. Pennzoil points out that assuming that such portion of the FERC's regulations and orders were applicable they would affect its interstate sales to Consolidated Gas Supply Company (Consolidated) as well. Pennzoil's sales to Consolidated consist of commingled volumes of produced and purchased gas. Since the Company's interstate sales to Consolidated are regulated by the FERC as "first sales" the Company does not believe that the Commission can now apply a different rate to the same mix of gas merely because it involves sales from its general system supply to the Company's utility customers in West Virginia.

Next, Pennzoil claims that a contract is not necessary to
sell its gas at NGPA rates. The Company interprets the
Act to state that one cannot have a contract which is in-
6 consistent with the requirements and ⊥ qualifications
necessary to charge NGPA rates. Pennzoil contends that
the staff suggestion that a contract is needed to collect
NGPA prices presupposes that the NGPA is applicable.
If it was not, the Company believes that the contract

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[13] **FERC Order No. 58 (November 14, 1979); FERC Order No. 102 (October 3, 1980).**

question would have never arisen. Pennzoil contends that the Commission has historically utilized its cost of purchased gas to price its own produced gas for inclusion in the rates and charges it collects from its retail customers in West Virginia and that if the Commission, for whatever reason, would conclude that the NGPA pricing structure does not apply in this case the lowest price supported by evidence of record is staff's unit cost figure of $2.489.

Section 602(a) of Title VI of the NGPA specifically provides that the Act shall not affect the authority of any state to establish or enforce any maximum lawful price for the first sale of natural gas produced in such state which does not exceed the applicable maximum lawful price, if any, under Title I of the NGPA. Citing to page 124 of the Conference Report the Company interprets such section of the NGPA to clothe the state with the authority to establish maximum lawful prices for sales of gas in intrastate commerce as long as the price does not exceed the maximum lawful price set out in the NGPA. Pennzoil takes the position that Section 602 of the act resulted from Congress's intent to cede a portion of its authority under the Commerce clause of the United States Constitution to regulate prices to the affected states. The Company asserted that such language raised two questions, i.e. to what gas does Section 602 apply and secondly, who within the state has the authority to set the lower price. The Company argues that Section 602 applies to only intrastate gas that is produced in a state, sold in a state and remains in intrastate facilities for the entire gas transportation from the wellhead to the end user. Pennzoil argues that since its produced gas is comingled with its purchased gas and sales are made off of the comingled supply to both Consolidated and to its retail consumers in West Virginia, its produced gas is travelling in interstate commerce and thus not subject

to the state's right to prescribe lower maximum lawful prices under Section 602. Such argument implies that even though the word intrastate or interstate is not contained within the act, it was Congress's intention to only grant the states the authority to prescribe lower maximum lawful
7 prices for the sale of gas in purely ⊥ intrastate transactions. Assuming that Section 602 of the NGPA applies to Pennzoil's comingled gas in West Virginia, which the Company does not believe is a reasonable interpretation, the Company contends that the only authority in a state which can set lower prices is a state legislature. Pennzoil takes the position that before § 602 can be effectively utilized a state legislature must enact a law prescribing lower maximum lawful prices for purely intrastate transmissions and sales of non-comingled natural gas or have clothed the appropriate state agency to act on its behalf with regard to such intrastate sales.

2. *Commission Staff*

At oral argument the Commission staff voiced agreement with the hearing examiner's conclusion that the NGPA is not applicable to the gas produced by Pennzoil and sold to its utility customers. Thus, the rates of $3.31 and $2.489 (see page two herein), both being NGPA related rates, are inappropriate prices for the Company's produced gas. The only difference between the $3.31 per Mcf and the $2.489 per Mcf is the variance in the mix of qualified and non-qualified NGPA gas contained within the calculation; the first price represents the Company's gas sales and the second price represents the Company's gas purchases. As increasing amounts in both the Company's purchases and sales of gas qualify for NGPA prices, both figures will increase over time. Staff contends that the Company's sales to its retail customers cannot be priced at NGPA rates because such sales do not qualify as a first sale as defined in § 2(21).[14] Staff argues that Pennzoil is a local distribution company as defined in the NGPA[15] and as such its gas sales fall within those certain sales described in Part B of § 2(21), which do not qualify as "first sales". Part B of § 2(21) states that a first sale does not include the sale of any volume of natural gas by a local distribution company or any affiliate thereof unless such sale is *attributable* (emphasis added) to volumes of natural gas produced by such local distribution company or any affiliate thereof. Staff cites two instances in which the FERC has found that the comingling of produced and purchased gas within a company's gas supply disqualifies sales from such supply from first sale treatment.

On November 14, 1979, the FERC adopted its final regulations with regard to Section 270.203 of Part 270, Subchapter H, Chapter I, Title 18, of the Code of Federal Regulations entitled "Pipeline, Distributor and Affiliate Production". In § 270.203(a), the FERC adopted an attribution rule for pipelines and distributors for the purpose of applying § 2(21)(B) of the NGPA. Such regulation provides that a sale by a pipeline or distributor is a sale of natural gas *attributable* (emphasis added) to the volume of natural gas produced by such pipeline or distributor to the extent that such sale was comprised exclusively of production volumes of natural gas from identifiable wells, properties, or reservoirs which are owned by such pipeline or distributor. FERC order No. 58 clearly states that "mixed volume sales by a pipeline or distributor are not considered to be first sales under the attribution rule" (April 28, 1981, Tr., p. 80). Staff argues that the FERC's reasoning in Order No. 58 was premised on its belief that Congress did not intend for pipeline or distributor sales from general system supply to qualify as "first sales" merely because some portion of that supply consisted of a company's own production. Staff points to the FERC's rationale that if the Commission (FERC) were to treat all pipeline or distributor sales as first sales where any portion of the volume of gas sold was produced by the pipeline or distributor, the FERC's regulation would extend to retail sales by interstate pipelines to their direct sale industrial customers. The FERC would also be exercising "first sale" jurisdiction over sales by intrastate pipelines and local distributors of volumes produced by these companies. FERC Order No. 58 states that "retail sales by interstate pipelines, intrastate pipelines and local distribution companies have traditionally been regulated by the states."

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[14] Ibid. Footnote No. 3.

[15] Table of Contents—Section 2—Definitions

(17)—Local Distribution Company.—

The term "local distribution company" means any person, other than any interstate pipeline or any intrastate pipeline engaged in the transportation, or local distribution, of natural gas and the sale of natural gas for ultimate consumption.

On October 3, 1980, the FERC issued Order No. 102 denying requests for rehearing of Order No. 58 and reiterating its position that if the source of the volumes that comprise a gas sale cannot be identified exclusively as the pipeline's or distributor's own wells, properties or reservoirs, the FERC will not accord first-sale treatment to the sale. A sale comprised of comingled volumes of purchased gas and pipeline production does not meet this test. In Order No. 102 the FERC additionally stated that it found no evidence in § 2(21)(B) of the NGPA or any other
9 ⊥ provision of such statute that suggests that Congress intended to require the Commission (FERC) to expand the field of federal ratemaking authority (which has tradi-

tionally under the NGA only extended to the regulation of wholesale rates of interstate pipelines) to include all mixed volume retail sales by intrastate pipelines or local distribution companies, the regulation of which has been the historical preserve of the states. Staff concludes that because Pennzoil's sales to its retail customers from its Company's comingled volumes of purchased and produced gas do not qualify as "first sales", the Company is not entitled to include NGPA prices for its own produced gas in its West Virginia retail prices.

Staff opposes the $2.489 per Mcf price for the same reason that it opposes the $3.31 per Mcf price. Staff contends that the former rate is really an NGPA price even though it was arrived at through the utilization of a seven-month average of the Company's purchased gas cost. Since the NGPA is not appropriate in one instance it is not appropriate in another. Staff states that before an independent producer can qualify for an NGPA rate he must establish that he has a contract authorizing the collection of the FERC-regulated price, that it is the first sale of gas as defined in § 2(21) of the NGPA, and that the sale of such gas qualifies for one of the classifications set out in the NGPA. Staff further contends that not only does Pennzoil's mixed volumes of gas fail to qualify as a first sale but it further has failed to produce a contract authorizing it to collect NGPA prices. Staff takes the position that Pennzoil is only entitled to recover from its retail customers in West Virginia the actual cost of producing its gas plus a fair return on investment and that nothing in the federal statutes, regulations or its contracts require a different measure to price the gas it provides to its retail customers. Staff also points out that the Commission in the past has priced Pennozil produced gas at the IOGA rate as a substitute for cost. In Pennzoil's previous rate case, Case No.

79-145-G-42T, the Company was ordered to perform an actual expense based determination of the cost of its natural gas production and gathering functions and make such available to the Commission. Such study was performed, however, the Company did not choose to sponsor it as an exhibit in this case. Although acknowledging that a proper cost of service study with regard to Pennzoil's cost of producing and gathering gas would be better evidence of cost, Staff contends that the $1.3945 rate adopted by the hearing examiner in this case is just and reasonable and the only cost related or considered rate before the Commission and as such should be adopted as the amount includable in the Company's rates and charges to its retail customers in West Virginia.

Summary and Decision

A. *Background*

The following is a summary of Pennzoil's average number of customers, gas sales and revenues and its quantities of gas produced and purchased for the past six calendar years.[16]

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[16] Taken from the Annual Reports of the Pennzoil Company for such years.

	Average No. of Customers	Mcf of Gas Sold (000)	($) Operation Revenues (000)	Mcf Gas Produced (000)	Mcf Gas Purchased (000)
1975					
Retail	4,524	644.5	542.0	2,838.3	2,106.6
Commercial	256	68.3	46.1		
Total	4,780	712.8	588.1		
1976					
Retail	4,696	688.0	576.9	2,676.9	2,000.9
Commercial	251	58.1	46.9		
Total	4,947	746.1	623.8		
1977					
Retail	4,855	755.1	630.6	2,496.5	1,897.6
Commercial	249	78.9	62.5		
Total	5,104	834.0	693.1		
1978					
Retail	5,000	842.3	1,112.7	2,295.8	1,865.2
Commercial	248	84.2	102.2		
Total	5,248	926.5	1,214.9		
1979					
Retail	5,064	706.5	1,104.3	2,640.5	1,717.6
Commercial	241	72.5	100.5		
Total	5,305	779.0	1,204.8		
1980					
Retail	5,230	686.4	1,798.0	2,940.0	1,576.0
Commercial	229	77.9	178.4		
Total	5,459	764.3	1,976.4		

During 1979 (the test year for this case) Pennzoil sold a total of 778,989 Mcf of natural gas to approximately 5,305 residential and commercial customers in a 22-county area. During the test year the Company produced 2,640,458 Mcf of natural gas and purchased 1,717,607 Mcf of natural gas for a total system amount of 4,358,065 Mcf. The Company produces and purchases more than enough gas to meet the needs of its residential and commercial customers. However, due to the differences in geographical loca-

tions of its customers in relation to its gas production facilities, Pennzoil cannot meet all the needs of its retail customers with its own production and, therefore, it purchases gas to make up the difference in those areas in which its
11 gas production is ⊥ not sufficient to meet such needs. Also during the test year Pennzoil sold 3,154,268 Mcf of natural gas in sales for resale generating $6,260,778 in revenues. Although six different companies received deliveries from the Company's mixed volumes of purchased and produced gas, over 95 percent of the gas was purchased by Consolidated Gas Supply Corporation. Approximately twenty percent of the Company's test year purchased and produced gas was sold to its retail consumers and the remaining amount was purchased primarily by Consolidated Gas Supply Corporation and Columbia Gas Transmission Corporation. (Annual Report of Pennzoil Company for year ended December 31, 1979).

In 1980[16A] the average number of residential gas customers of the Company increased by 166 while at the same time retail sales decreased by 20,142 Mcf to a level of 686,352 Mcf. However, income from residential sales increased by the amount of $693,775 or approximately 63 percent. Pennzoil lost on the average twelve commercial customers during 1980; however, commercial sales increased by the amount of 5,491 Mcf to attain the level of 77,986 Mcf. Commercial sales revenue increased by the amount of $77,912 or by approximately 77.5 percent. Thus, during the year 1980 the Company gained an average of 154 customers but experienced a reduction in sales of 14,651 Mcf. During the same period Pennzoil enjoyed a $771,687 increase in operating revenues from its retail

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[16A] **1980 includes approximately three months of the rates requested by Pennzoil in this case.**

customers (a 64 percent increase). Pennzoil's 1980 sales for resale revenue increased by $4,422,096 or approximately 71 percent. However, the Company's per Mcf sales only increased by the amount of $226,089 or seven percent. In 1980 Pennzoil also experienced an additional $8,199,382 in incidental gasoline and oil sales revenue for an increase of 42 percent over the previous year. The Company also increased its other gas revenues in the amount of $46,666 or a 49 percent increase. The issue now before the Commission as in past rate cases filed by this Company involves the ascertainment of the appropriate price to be set for Pennzoil's produced gas for inclusion in the rates it charges its retail customers in West Virginia.

An adequate and competent cost of service study with regard to the cost that Pennzoil incurrs in producing its own gas with a proper allocation or division between the Company's oil operations and its gas operations would normally form the most appropriate basis for pricing
Pennzoil's gas production. Having had to price Pennz- 12
oil's gas production without the benefit of having such a study in the past, the Commission in Case No. 9025 utilized the average IOGA rate before reduction for gathering system cost to price the Company's produced gas. In Case No. 79-145-G-42T the Commission, in affirming the hearing examiner's recommended decision, again pointed to the difficulty if not impossibility of separating the cost of oil and gas production in affirming the hearing examiner's pricing of Pennzoil's produced natural gas at the IOGA rate. Such prior decisions as well as the examiner's decision in this case, found that the IOGA rate was a reasonable substitute for the actual cost of Pennzoil's produced gas. After reviewing the evidence of record in this case and hearing oral argument on the exceptions filed to the hearing examiner's decision, the Commission does not disagree

with the examiner's adoption of the IOGA rate as a starting point upon which to calculate the appropriate price for Pennzoil's produced gas.

As the Company points out on page 14 of its exceptions the W.Va. Code authorizes and requires the Commission to enforce and regulate Pennzoil's practices, services and rates in order to insure that its rates and charges are just, reasonable, applied without unjust discrimination or preference and based primarily on the cost of providing such services.[17] At the same time Pennzoil is arguing that the NGPA, which increased the regulated price of natural gas to encourage national conservation as well as increased exploration and development, requires the Commission to price Pennzoil's produced gas at a rate that has no bearing or relationship to the cost of gas production.

B. *Jurisdiction*

Prior to the enactment of the NGPA in November 1978 the Federal Power Commission (FPC) under the authority of the Natural Gas Act (NGA) regulated the wholesale prices and interstate transmission of natural gas in the United States. Regulation of retail sales by local distribution companies was performed by the various states. During the 1970's a scarcity of natural gas production caused the price of natural gas to escalate on an intrastate basis while
13 the prices regulated by the FPC increased at a much slower rate. As a result the supply of gas forthcoming from the various producing states into interstate commerce slowed somewhat. As the result of the shortage of gas several curtailment proceedings were instituted under the NGA. In November of 1978 the Congress enacted the NGPA of 1978 to solve the nation's problem of decreasing

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[17] W.Va. Code § 24-1-1(a)(4).

supplies of natural gas. The Act set maximum lawful price ceilings for several different classifications of natural gas and extended federal regulation to the first sale of any volume of natural gas moving from a wellhead to transportation facilities and ultimately to distribution facilities for retail consumption. The Congress, in enacting the NGPA, recognized that in addition to acquiring and transporting gas for sale pipelines and distributors also engaged in production activities. A distinction between a pipeline or distributor's producer or field sales and other sales that remain subject to the Federal Energy Regulatory Commission (FERC) or state jurisdiction was drawn. Section 2(21)(B) of the NGPA provided that a first sale:

> ". . . shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless the sale is *attributable* (emphasis added) to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof".

In Order No. 58 the FERC promulgated § 270.203 of its final regulations wherein it adopted an Attribution Rule to aid in the determination of which sales of natural gas by pipelines, local distribution companies, or affiliates thereof are first sales within the meaning of § 2(21)(B) of the NGPA. Section 270.203(a) provides that:

> "For purposes of applying § 2(21)(B) of the NGPA, a sale by a pipeline or distributor is a sale of natural gas attributable to volumes of natural gas produced by such pipeline or distributor to the extent that such sale is comprised exclusively of production volumes of natural gas from identifiable wells, properties, or reservoirs which are owned by such pipeline or distributor."

The FERC interpreted § 2(21)(B) of the NGPA to
distinguish between pipeline and distributor sales occurring
at the wellhead or in the field and sales from a pipeline's
or distributor's general system supply. It noted that while
wellhead or field sales were clearly sales attributable to a
pipeline's or distributor's own production, sales from a pipe-
line's system supply are comprised of comingled volumes
of purchased gas and pipeline production. The FERC con-
cluded that the distinction between these two types of pipe-
14 line and distributor sales embodied in § 270.203 of its
regulations was consistent with the language in § 2(21)(B)
and with the legislative objective of coordinating the pricing
scheme of Title I with the ongoing jurisdiction of the Com-
mission and state and local authorities to determine rates
for the sale of natural gas transported for sale by pipelines
and distributors.

In Order No. 102, the FERC denied requests for rehearing of § 270.203 of its final regulations. In such order the FERC again interpreted § 2(21)(B) as speaking in terms of sales, not volumes of natural gas. It noted that if the source of the volumes that comprised the sale cannot be identified as the pipeline's or distributor's own wells, property or reservoirs, the Commission (FERC) will not accord first sale treatment to the sale. A sale consisting of comingled volumes of purchased and produced gas does not meet this test. The FERC believes the NGPA makes the distinction between pipeline sales from general systems supply and pipeline sales that occur at the wellhead. This distinction is necessary to preserve the existing division between state and federal pipeline regulation and to preserve the Natural Gas Act (NGA) cost of service rate-making scheme for sales from interstate pipelines' general system supply. The Commission (FERC) found no evidence in § 2(21)(B) or in any other provision of the NGPA that suggests that Congress intended to require the FERC to expand the field of federal rate-making authority to include all mixed volume retail sales by intrastate pipelines or local distribution companies, the regulation of which has been the historic preserve of the states.

The Commission does not find that the hearing examiner's decision in this matter was based upon a misapplication of legal principles. Pennzoil is a local distribution company with regard to its West Virginia retail customers. As such the comingling of its own produced gas with the gas that it purchases from others disqualifies the Company from claiming first sale treatment for the sales it makes from its general system supply. The hearing examiner's determination that NGPA prices for Pennzoil's produced gas did not apply to the Company's sales to its retail customers in West Virginia is correct.

Generally, as natural gas travels from wellheads across the state and nation it is gathered and first sold to various transmission pipelines through which it travels on its course to various distribution facilities ⊥ for ultimate sale to numerous retail consumers. During the test year Pennzoil produced approximately 60 percent of the gas it sold and purchased the other 40 percent. Approximately 20 percent of the total amount of the Company's produced and purchased gas was sold to its retail customers in West Virginia. Of that 20 percent this Commission has priced 40 percent of such sales at the price at which the Company purchases its gas. The price the Company should collect for the other 60 percent of such sales is the issue now before the Commission. Pennzoil's sales of its produced gas from its general system supply to its retail customers is the first time such gas is sold. Such amounts of gas are produced in this state, sold in this state and remain in Pennzoil's facilities for the entire gas transportation from the wellhead to the end user.

Pennzoil would have the Commission apply first sale treatment to an intra-corporate transaction. Such a request was made of the FERC by several companies who petitioned the Commission (FERC) to reconsider § 270.203 of its final regulations promulgated in FERC Order No. 58. The FERC concluded that the regulation and enforcement of rates for sales of pipeline production should not be dependent on an event that is recorded solely on the books and records of the Company and that occurs without contract, bargaining, or certification. We find no reason for this Commission to follow a different conclusion.

The Commission is of the opinion that the hearing examiner's discussion of the "first sale" requirement of the NGPA is sufficient legal ground upon which to find inappropriate Pennzoil Company's utilization of $3.31 as the lawful price for its produced gas.

C. *The Appropriate Price for Pennzoil's Produced Gas*

The evidence of record in this case contains five different prices per Mcf from which the hearing examiner made his choice. Such figures are as follows:

1. $4.69,
2. $2.747,
3. $3.31,
4. $2.489,
5. $1.3945.

The first two figures were based on or derived from a production and gathernig cost study prepared by Pennzoil in compliance with the Commission's order in Case No. 79-145-G-42T which was found to be incompetent as evidence as a result of the Company's failure to sponsor

⊥ such study with a witness to testify regarding the 16
study's identification authenticity and accuracy. Thus, neither the Company's figure of $4.69 nor the Staff's figure of $2.747, derived through adjustments to such study, are supported by competent evidence. The third figure of $3.31 is the price utilized by the Company in its Rule 42 exhibit. It was calculated using a weighted average rate based on the appropriate provisions of the NGPA. As a result of the Company's ineligibility for "first sale" treatment under the NGPA, the $3.31 figure for which Pennzoil sells its gas to its various wholesale purchasers should not be used by the Commission. In addition, the fourth figure originally recommended by Staff and developed from Pennzoil's average purchased gas cost for the seven months ending July 31, 1980, cannot be utilized by the Commission for the same reason. The first and second figures above are based upon incompetent evidence and cannot fairly be considered by the Commission; the third and fourth figures are NGPA-considered numbers and differ only in regard to the mix of the NGPA-qualified gas in their calculations. The fifth figure of $1.3945 includes a gathering cost calculation of 61 cents per Mcf and a production cost of 67.85 cents per Mcf and a B&O tax computation of 10.60 cents per Mcf. The production cost of 67.85 cents is the current (January 1981) "IOGA rate" (adjusted for inflation) which resulted from litigation settlements before the FPC (the predecessor of the FERC) brought by various Appalachian independent producers in the mid-1970's to convince the FPC that its then current price regulation was not sufficient to cover the then current cost of producing and developing natural gas in the Appalachian area. Thus, since the fifth figure is the only number reasonably related to the cost of producing gas in the Appalachian area the Commission, as was the hearing examiner, is of the opinion that the IOGA rate

should be utilized as a base in determining the appropriate price that Pennzoil's retail customers should pay for the Company's produced gas.

In reviewing the hearing examiner's decision to adopt the figure of $1.3945 per Mcf as the appropriate price for the Company's produced gas for rate making purposes, the Commission is of the opinion that such amount does not adequately represent Pennzoil's current cost of producing gas since the IOGA settlements were made in the mid 1970's. Thus, the Commission has adjusted the 65.14 cent
17 IOGA rate, adopted by the Commission ⊥ in Case No. 9025 for the Pennzoil Company, by the cumulative GNP deflator index for the period June, 1976, through June, 1982.[18] Such $1.01 production cost coupled with the 61 cent gathering cost utilized by the hearing examiner and hereby adopted as reasonable (see Page 11 of his decision), together with the Business and Occupation Tax of 8.63 percent levied by the State of West Virginia on gas production, results in a total price of $1.773.[19] Such figure is a just and reasonable price for Pennzoil's produced gas sold to its West Virginia retail customers. A properly prepared cost of service study, however, is still the more reliable model to use in pricing Pennzoil's production. Absent such a study, the $1.773 figure is hereby adopted for the purposes of this case.

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[18] 65.14 cents × 1.55 = 100.967 cents or $1.01.

[19]

Production cost	—	$1.01
Gathering cost	—	$ .61
Total before B&O tax	—	$1.62
B&O tax on gas production at 8.63%	—	$ .153
Total	—	$1.773

Findings of Fact and Conclusions of Law

1. The figures of $4.69 and $2.747 are unjust and unreasonable numbers to be used in the pricing of Pennzoil's produced gas in that they are derived from incompetent evidence (see Page 6 of Hearing Examiner's Decision; and Staff Exhibits Nos. 3 and 4).

2. The figures of $3.31 and $2.489 are both unjust and unreasonable for use as the price for Pennzoil's produced gas because both figures include quantities of gas priced at NGPA levels when such quantities of gas do not qualify as a "first sale" as required by the NGPA to entitle Pennzoil to collect the prices therein established. (See § 2(21) of the Table of Contents of the NGPA; FERC Regulation § 270.203; FERC Order No. 58; and FERC Order No. 102).

3. The Commission's authority and duty to establish the appropriate price for Pennzoil to include in its rates and charges for its own produced gas sold to its West Virginia retail customers has not been preempted by the NGPA, the NGA, or the FERC, through its regulations and orders issued pursuant thereto.

4. The figure of $1.3945 per Mcf as utilized by the hearing examiner in calculating his cost of service for Pennzoil is not a just and reasonable price for the Company's produced gas because it does not ⊥ adequately 18
reflect the current cost of the Company's gas production since the IOGA settlements were made in the mid 1970's.

5. The Commission has jurisdiction to set just and reasonable rates primarily based on the cost that Pennzoil incurs in providing gas service to its retail customers in West Virginia. (See W.Va. Code §§ 24-1-1, 24-1-2, 24-2-1, 24-2-2, 24-2-3, 24-2-4, and 24-2-7).

6. Pennzoil is a local distribution company with public utility service duties and responsibilities with regard to its retail customers in West Virginia. (April 28, 1981, Transcript p. 112; § 2(17) of Table of Contents of NGPA; W.Va. Code §§ 24-2-1 and 24-1-2).

7. For the purposes of this case the price of $1.773 per Mcf is a just and reasonable rate for Pennzoil to collect from its retail customers for the Company's own produced gas.

8. The language contained in the Company's tariff contained in Appendix B, attached hereto, is reasonable (April 28, 1981, Transcript, pp. 71, 116).

ORDER

1. The rates and charges contained in the Fourth Revision of Original Sheet No. 14 of P.S.C. W.VA. No. 1, are unreasonable and unjust in that they do not generate sufficient revenue for Pennzoil to pay its reasonable and necessary operating expenses, to pay its taxes, to earn a fair rate of return on investment, and to finance necessary capital improvements.

2. The rates and charges contained in Fifth Paragraph Sheet No. 14 of P.S.C. W.Va. No. 1 and placed into effect, subject to refund, on or about October 8, 1980, are unreasonable and excessive in that they will generate revenue in excess of that needed for the purposes set forth in paragraph 1.

3. The rates and charges set forth in Appendix B attached to the hearing examiner's decision of February 17, 1981, are unreasonable and unjust because (1) they do not reflect a just and reasonable price per Mcf for Pennzoil to collect from its retail customers for the Company's own

produced gas, (2) they do not reflect a just and reasonable price per Mcf for the Company's purchased gas (see Footnote No. 1), and (3) they do not accurately reflect the hearing examiner's decision regarding interest expense. In all other respects the Commission adopts the hearing examiner's decision as its own in this matter.

4. The rates and charges set forth in Appendix B, attached hereto, are authorized and approved as just and reasonable in that they will produce no more revenue than is necessary for the purposes set forth in paragraph 1 for the period beginning October 8, 1980. 19

5. The Respondent, Pennzoil Company, shall within thirty (30) days of the date of this order file its tariffs with the Commission containing the approved and authorized rates and charges as hereinafter set forth.

6. The Respondent shall refund to each of its customers within sixty (60) days from the date of this order the difference between the amounts collected under Fifth Revised Sheet No. 14 of P.S.C. No. 1 and the rates and charges approved in Appendix B, attached hereto, with interest at the rate of fourteen percent (14%) per annum for the period beginning October 8, 1980 to the date of refund. Refunds of five dollars ($5.00) or less may be made by crediting the amount to the customer's account. Refunds in excess of five dollars ($5.00) shall be made by check unless the customer's account is past due, in which case the refund may be credited to the account to the extent of said past due balance. The Company shall report to the Commission, within sixty (60) days of the date this order becomes final, the amount refunded, the manner of refund, and the amount, if any, which it has been unable to refund.

7. In its next general rate case proceeding, the Respondent shall prepare and make available to the Commission an actual expense based determination of the cost of its natural gas production, gathering and/or transmission functions prepared according to generally accepted accounting principles. Such cost base study shall make the appropriate division between the Company's oil and gas operations.

8. The Executive Secretary is hereby ordered to serve a copy of this order upon the Commission Staff by hand delivery, and upon all parties of record by United States Certified Mail, return receipt requested.

A TRUE COPY

TESTE:

/s/ Howard M. Cunningham
HOWARD M. CUNNINGHAM
Executive Secretary

Commissioner Casto did not participate in this decision.

APPENDIX A

PENNZOIL COMPANY
COST OF SERVICE
Case No. 80-175-G-42T

Operation and Maintenance Expenses	$2,106,400*
Depreciation	63,573
Taxes other than FIT @ going level	110,867
Federal income tax	29,995**
Credits to cost of service	(5,173)
Allowance for return—14%	113,971
Subtotal	2,419,633
B & O taxes on deficiency	36,359
TOTAL COST OF SERVICE	$2,455,992
Increase required over going level revenue of $1,608,460	$ 847,532

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* Expenses per 2-17-81 EED	$1,505,379
Add purchased gas costs	422,758
Add increased production allowance	178,263 (a)
Adjusted expenses	$2,106,400

** Reflects interest expense of $55,700 per pages 8 and 9 of the hearing examiner's decision rather than $34,557 reflected in original Appendix A attached to the hearing examiner's decision.

(a) ($1,773 −$1.3945) × 470,971 MCF = $178,263

APPENDIX B

PENNZOIL COMPANY
AUTHORIZED RATES

Case No. 80-175-G-42T

AVAILABILITY OF SERVICE

Available for the requirements of any authorized applicant on basis of eight ounce (8 oz.) pressure.

CUSTOMER CHARGE *(no consumption included)*

Per month—$5.00

CONSUMPTION CHARGE

One (1) Mcf and greater used through each meter each month—$3.248 per Mcf.

DELAYED PAYMENT PENALTY

The above schedule is net. On all accounts not paid in full within twenty (20) days of the date of bill, three (3) cents per Mcf will be added to the net amount shown. This delayed payment penalty is not interest and is only to be collected once for each bill where it is appropriate. The above rates include a purchased gas cost of $0.953 per Mcf approved by order of the Commission dated October 31, 1980, in Case No. 80-330-G-30C.

APPENDIX C

SUPREME COURT OF APPEALS
STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 19th day of January, 1982, the following order was made and entered, to-wit:

PENNZOIL COMPANY, a corporation

vs.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

On a former day, to-wit, January 11, 1982, came Pennzoil Company, a corporation, by Patricia A. Curran, Goodwin & Goodwin and C. E. Goodwin, Baker & Botts, Bruce F. Kiely and Kirk K. Van Tine, its attorneys, and moved the Court to suspend the time requirement prescribed by the Code 24-5-1 to permit Pennzoil Company to renew its petition for appeal, which motion, upon consideration, the Court is of opinion to and doth, hereby deny.

A True Copy

Attest: /s/ George W. Singleton
Clerk Supreme Court of Appeals

APPENDIX D

STATUTES

Natural Gas Policy Act of 1978,
Section 2(21), 15 U.S.C. § 3301(21).

SEC. 2. DEFINITIONS.

. . .

(21) FIRST SALE.—

(A) GENERAL RULE.—The term "first sale" means any sale of any volume of natural gas—

(i) to any interstate pipeline or intrastate pipeline;

(ii) to any local distribution company;

(iii) to any person for use by such person;

(iv) which precedes any sale described in clauses (i), (ii), or (iii); and

(v) which precedes or follows any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act.

(B) CERTAIN SALES NOT INCLUDED.—Clauses (i), (ii), (iii), or (iv) of subparagraph (A) shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.

Natural Gas Policy Act of 1978,
Section 602, 15 U.S.C. § 3432.

SEC. 602. EFFECT ON STATE LAW.

(a) AUTHORITY TO PRESCRIBE LOWER MAXIMUM LAWFUL PRICES.—Nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under title I of this Act.

(b) COMMON CARRIERS.—No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—

(1) pursuant to any order under section 302(c) or section 303(b), (c), (d), or (i) of this Act; or

(2) authorized by the Commission under section 311 (a) of this Act.

APPENDIX E

664 F.2d 530

UNITED STATES COURT OF APPEALS, FIFTH CIRCUIT.*

UNIT A

Dec. 23, 1981.

Nos. 80-3804, 80-4010.

MID-LOUISIANA GAS COMPANY, et al., *Petitioners,*

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

CONSOLIDATED GAS SUPPLY CORPORATION, et al.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petitions for Review of Orders of the Federal Energy Commission. ⊥ 532

Before CLARK, Chief Judge, GARZA and SAM D. JOHNSON, Circuit Judges.

CLARK, Circuit Judge:

Petitioning pipeline producers of natural gas seek review of two issues concerning the scope and administration of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3301 et seq. (Supp. III 1979). Their initial claim is that the Federal Energy Regulatory Commission (Commission)

*** Former Fifth Circuit case, Section 9(1) of Public Law 96-452—October 14, 1980.**

incorrectly determined in Order No. 58 that the pricing structure established by the NGPA was not applicable to most gas produced by pipeline companies. Because we find this claim correct, we do not reach the producers' alternate claim that, if the Commission retained jurisdiction to establish the price of such gas, it abused its discretion in Order No. 98 by denying higher prices to gas which had previously been priced on a cost-of-service basis.

I.

Prior to the NGPA, the price for both the production and transportation of gas was regulated by the Commission under the Natural Gas Act of 1938 (NGA), 15 U.S.C. § 717 (1976). Under the NGA, the cost of gas which was brought by the pipelines for resale in interstate commerce was set according to area or national rates. Although the majority of gas transported by pipelines was bought from independent producers, some pipelines also produced their own gas, which was combined with gas bought from independent producers, and transported to their customers downline. The Commission treated the pipelines' intracorporate transfer of its own production as if it had been bought from another entity and determined its "cost" to the pipeline applying the same area or national rates the Commission applied to independently produced gas. The Commission determined the pipelines' sales price to its
533 customers on a cost-of-service basis.[1] ⊥

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[1] Basically, cost-of-service pricing adds the costs required to operate and maintain the pipeline to the cost of both the gas purchased from independent producers and the gas produced by the pipeline itself, then calculates and includes an additional amount to allow reasonable return on the pipeline's investment. The Commission initially had determined the cost of pipeline production on a cost-of-service basis, but began applying area rates to pipeline production in 1969. However, it continued to price pipeline production from

The fuel shortages of the 1970s revealed two flaws in the regulation of gas production. The first appeared when the area and national rates established by the Commission for gas sold on the interstate market fell markedly below the price available for gas sold on the intrastate market, which was not regulated by the Commission. The price disparity between the two markets skewed the distribution of gas and resulted in shortages of gas available for interstate sale. *See Air Products & Chemicals, Inc. v. FERC*, 650 F.2d 687, 705 (5th Cir. 1981). The second became apparent when the area and national rates established by the Commission did not provide a sufficient incentive to encourage exploration for new sources of gas. *See Pennzoil Co. v. FERC*, 645 F.2d 360, 367 n.13 (5th Cir. 1981). These two problems resulted in enactment of the NGPA. While the NGPA did not disturb the Commission's jurisdiction over the prices a pipeline could charge its customers, it did take away from the Commission the right to fix most prices paid for the production of natural gas.

In the NGPA, Congress defined several categories of natural gas and set maximum lawful prices for the "first sale" in each. The pipelines claim that because Congress intended for the NGPA to apply to both pipeline and independent production, the Commission's order defining "first sale" conflicts with the NGPA.

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leases acquired prior to 1969 on a cost-of-service basis. *See Chicago v. FPC*, 458 F.2d 731 (D.C.Cir.1971), *cert. denied*, 405 U.S. 1074, 92 S.Ct. 1495, 31 L.Ed.2d 808 (1972). The Commission subsequently provided that pipeline production on old leases from wells begun after January 1, 1973, would receive nationwide rates. *See Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir.), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49 L.Ed.2d 394 (1976). These exceptions to the application of area or national rates represent historical practices the effect of which is continually diminished as early wells cease producing gas. They do not affect our decision.

II.

The NGPA generally defines "first sale" as "any sale of any volume of natural gas," to a specified purchaser. 15 U.S.C. § 3301(21)(A). However, this general definition is subject to a qualified exception which is crucial to the issue presented here. The subsection following the general definition provides that "first sale" shall *not* include "the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof." 15 U.S.C. § 3301(21)(B).

In Order No. 58, the Commission assumed that the sale referred to by section 3301(21)(B) was a transfer by the pipeline to its customers. The Commission found that such a transfer was not a "first sale" unless the gas transferred was exclusively attributable to the pipeline's own production. Thus, it provided that if a pipeline commingled gas produced by it with gas produced by other entities, the pipeline was not entitled to NGPA prices for the gas it produced.

Because sales by pipelines are normally comprised of commingled gas, the Commission acknowledged that its regulation denied NGPA prices to virtually all pipeline produced gas and that FERC would retain jurisdiction under the NGA to set the price of such gas. The Commission justified its regulation because it intruded the least into state regulation and because it was less difficult to administer.

Under the NGA, regulation of retail sales by interstate pipelines, intrastate pipelines and local distribution companies had been committed to the states. The Commission found that applying NGPA prices to such sales, particularly those by intrastate pipelines and local distribution companies, would supplant an area of regulation traditionally controlled by the states. The Commission also found that applying NGPA prices to pipeline customer sales of natural gas would disrupt the method it had traditionally used to factor transportation and other costs into the price charged for natural gas. Although treating the transfer from the production to the transportation ⊥ 534 division of the pipeline as a first sale would have eliminated the problems noted by the Commission, the Commission declined to do so because it had not previously treated an intracorporate transfer as a sale.[2]

III.

We have previously recognized that "an agency's interpretation of its own statute is generally given deference . . . ." *Columbia Gas Development Corp. v. FERC,* 651 F.2d 1146, 1155 (5th Cir. 1981). We have also recognized that a greater degree of deference results from such factors as (i) a long standing interpretation which has not been disturbed by congressional action, *see International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551, 566 n.20, 99 S.Ct. 790, 800, 58 L.Ed.2d 808 (1979); *Sanchez v. Schweiker,* 656 F.2d 966, 970 (5th Cir. 1981) (per curiam), (ii) the fact that "the interpretation concerns matters within the agency's expertise," *Adkins v. Hampton,*

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[2] In Order No. 98, the Commission, acting under the NGA authority it had recognized in Order No. 58, established prices for interstate pipeline sales which come from mixed volumes of pipeline and independent producer gas. The Commission allowed pipelines whose production had previously been priced according to area or national rates to sell gas at NGPA prices. It refused, however, to extend NGPA prices to pipelines whose production had been priced on a cost-of-service basis.

586 F.2d 1070, 1073 (5th Cir. 1978); *accord Office of Consumers' Council v. FERC*, 655 F.2d 1132, 1141 (D.C. Cir.1980), and (iii) the fact that a contemporaneous interpretation of the statute suggests that the agency personnel interpreting the act had a hand in its development. *See Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555, 100 S.Ct. 790, 797, 63 L.Ed.2d 22 (1980); *Phillips Petroleum Co. v. Wisconsin*, 347 US. 672, 689, 74 S.Ct. 794, 803, 98 L.Ed. 1035 (Douglas, J. dissenting). While the presence of these factors argues for greater deference, their absence suggests that a court need not accord as much deference as it otherwise would and indeed may rely on its own expertise in construing the intent of Congress. *See Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 42 n.27, 97 S.Ct. 926, 949, 51 L.Ed.2d 124 (1977); *Louisiana Chemical Association v. Bingham*, 657 F.2d 777, 779 (5th Cir. 1981).

In *Batterton v. Francis*, 432 U.S. 416, 425, 97 S.Ct. 2399, 2405, 53 L.Ed.2d 448 (1977), the Supreme Court recognized that when Congress "expressly delegated to [an agency] the power to prescribe standards" the resulting regulations should not be set aside by a court "simply because it would have interpreted the statute in a different manner." The Court distinguished legislative regulations, which are issued "pursuant to statutory authority and . . . implement the statute, as, for example, the proxy rules issued by the Securities and Exchange Commission," from merely interpretative regulations. *Id.* at 426 n.9, 97 S.Ct. at 2405 n.9. With respect to interpretative regulations, the Court noted that a lesser degree of deference is due, and stated "[v]arying degrees of deference are accorded to administrative interpretations, based on such factors as the timing and consistency of the agency's position and the nature of its expertise." *Id.*

Applying these factors to the present case, we find that
the Commission's definition of "first sale" in Order No. 58
has not yet received the sanction which comes from long
years of application by the agency and tacit congressional
acceptance.[3] Moreover, this definition does not concern an
area particularly within the agency's expertise. The Com-
mission concedes that the concept of "first sale" is new to
energy regulation, having been initially introduced by
President Carter in a message to Congress. Defining this
term does not bring into play the experience which the
agency has gained in administering the NGA nor does this
definition draw on the agency's expertise in dealing with
the technical problems associated with energy regulation.
The one factor which augments the deference due the Com-
mission is its contemporaneous interpretation of the statute.
The Commission ⊥ did have first-hand knowledge of the 535
problems leading to the passage of the NGPA. Yet, the
weight of this factor is diminished since the Commission
has admitted that it had no input into the development of
the term "first sale." In sum, these factors fall far short of
demanding a deference to the Commission's interpretation
of the statute which could challenge the clear meaning of
a statute as revealed by its language, purpose and history.
International Brotherhood of Teamsters v. Daniel, 439
U.S. at 566 n.20, 99 S.Ct. at 800; *see Mohasco Corp. v.
Silver,* 447 U.S. 807, 100 S.Ct. 2486, 2496, 65 L.Ed.2d
532 (1980); *Louisiana Chemical Association v. Bingham,*
657 F.2d 777, 779 (5th Cir. 1981).

IV.

"The starting point in every case involving the construction of a statute is the language itself." *International*

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[3] 15 U.S.C. § 3411(b) authorizes the Commission "to define, by rule, accounting, technical, and trade terms used in this chapter."

Brotherhood of Teamsters v. Daniel, 439 U.S. at 558, 99 S.Ct. at 795. Sections 3311-3319 of the NGPA set a price for the "first sale" of natural gas in defined categories. Section 3301(21)(B) provides: (i) the sale of gas by a pipeline is not a "first sale," (ii) unless the sale was attributable to the pipeline's own production.

The first part of section 3301(21)(B) has a clear purpose. If its denial of "first sale" status to pipeline sales had not been included in the NGPA, pipelines which bought gas produced by independent producers and then resold it would have been involved in two "first sales," once as purchaser from the independent producer and then as seller to its customer. The restriction operates to eliminate this possibility by denying "first sale" status to the downstream sale.

The Commission's interpretation of section 3301(21)(B) would effectively read the second part of this subsection out of the NGPA. By over-stressing the first provision that sales by a pipeline are not first sales, the Commission would render the unless clause of subsection (B) a nullity. *See Ideal Mutual Insurance Co. v. C.D.I. Construction, Inc.,* 640 F.2d 654, 658 n.7 (5th Cir. 1981).

This second part of subsection (B) has a purpose equally as clear as the first. As we show below, NGPA contemplates that the pipeline is both a buyer and seller as to its own production. Blotting out the unless clause would mean the sale it makes of natural gas to itself in an intracorporate transfer would be excluded from NGPA in the same way the sale to its downstream customer is excluded. If this construction is placed on the Act, all natural gas produced by a pipeline would be denied "first sale" status under NGPA. Nothing in the language used here or elsewhere in the NGPA suggests any intent to deny NGPA pricing to natural gas just because it is produced by a pipeline. To the contrary, the unless clause of subsection (B) can only have meaning if it is interpreted as granting "first sale" status to gas which is attributable to pipeline production. The pipeline's later sale of this gas to its customer would, of course, still be excluded from "first sale" treatment by the first part of the subsection.

The Commission claims that its interpretation of first sale is consistent with both the purposes of the statute and the legislative history. We disagree. Two of the overriding purposes of the NGPA were to eliminate the dual interstate and intrastate market for natural gas and to provide higher prices to encourage production. *See* H.R. Doc. No. 95-128, 95th Cong., 1st Sess. 5 (1977). Neither of these purposes is served by creating a distinction between pipeline and independent producers.

In achieving the goal of increasing natural gas production, pipeline producers deserve the price encouragement of NGPA no less than other producers. The Commission contends that it has encouraged increased production by extending NGPA prices to some pipeline producers in Order No. 98. This argument is sophistic. The Commission's duty is to administer the law Congress passed in light of the purposes for which it was passed. It is not an agency's prerogative to alter a statutory scheme even if its alteration is as good or better than the congressional one. The fact
that ⊥ the agency gives back all or part of what it takes 536
from the law's grant in no way justifies departure from the congressional purpose in the first instance.

With respect to the goal of eliminating a dual market structure, the Commission's order would exclude virtually all interstate pipeline, intrastate pipeline and local distribution company production from the NGPA's uniform prices.

While the Commission would retain control of interstate pipeline production under the NGA, the effect of its order would be to leave intact state regulation of intrastate pipeline and local distribution company production. The intrastate market for such production would thus be perpetuated. This would leave a substantial vestige of the dual market structure Congress sought to eliminate.

The legislative history of section 3301(21) does not illuminate this issue. Congress did not explain its definition of first sale either in the committee reports that accompanied the various drafts of the NGPA or in the discussions that occurred in each house.

The Commission would support its interpretation by noting that the term "first sale" is used in a subchapter titled Wellhead Pricing and that first sales are referred to as "wellhead" or "field" sales in the legislative history. The Commission reasons that because a sale by a pipeline to its customer cannot be a wellhead sale, Congress must have intended to deny pipeline production first sale status. The Commission's Order No. 58 is inconsistent with this reasoning because it recognizes that non-wellhead sales may be first sales. Order No. 58 would allow as a first sale a downline sale to a pipeline customer if the sale was exclusively attributable to pipeline production despite the fact that such a sale is no more a wellhead sale than is any other pipeline customer sale.

More importantly, the legislative history noted by the Commission conflicts with a premise which underlies Order No. 58. The Commission asserts that a problem is created by extending first sale status to pipeline production. The problem it perceives derives principally from its assumption that the first sale by the pipeline producer must be the sale to a customer downline. The legislative history equating a first sale with a wellhead or field sale suggests, however, that Congress intended the sale by the producer of the gas to be the first sale. In the context of pipeline production, this would mean that the intracorporate transfer from the production division of the pipeline to the transportation division of the pipeline would constitute the first sale. If the Commission had equated this intracorporate transfer with the acquisition of pipeline gas from an independent producer the "problems" it perceived and sought to solve in Order No. 58 would not have arisen.

Other provisions in the statute and such relevant legislative history as does exist persuade us that Congress both intended to accord pipeline production first sale status and contemplated that the intracorporate transfer would be treated as a first sale. Subchapter II of the NGPA provides for incremental pricing by the pipelines. Congress directed that pipelines pass through to certain industrial users the higher first sale acquisition costs paid by the pipelines for natural gas under NGPA. In defining first sale acquisition costs, Congress stated that the cost would be the price paid in any first sale. *See* 15 U.S.C. § 3343(b)(1)(A). Additionally, Congress provided that for "any natural gas produced by any interstate pipeline or any affiliate of such pipeline, the first sale acquisition cost of such gas shall be determined in accordance with rules prescribed by the Commission." 15 U.S.C. § 3343(b)(2). By referring to the "first sale acquisition cost of *such* gas," in terms of "any gas produced by any interstate pipeline," Congress must have contemplated that any gas produced by a pipeline would be subject to a first sale. Moreover, the fact that Congress provided that the "first sale acquisition cost" of pipeline produced gas would, like the first sale price paid to independent producers, be passed along to the pipeline's ultimate customers suggests that both prices were to be

537 treated in a similar manner. Congress contemplated ⊥ that the first sale acquisition cost for both pipeline and independent production would be treated as the cost of the gas to the pipeline in determining, under the cost-of-service method, the price charged by the pipeline. The first sale thus appears to refer to the intracorporate transfer.

The Commission contends that if Congress had intended pipeline production to be subject to first sales, it would not have treated pipeline production separately from other production for which there is a "price paid." This distinction, however, merely reflects Congress' awareness that technically an intracorporate transfer involves no price paid. It would appear that Congress intended for the Commission to apply NGPA prices as the "cost" of this gas to the pipeline, just as the Commission had applied area and national rates under the NGA to determine the "cost" to the pipeline of pipeline produced gas.

Support for the proposition that the intracorporate transfer constitutes a first sale is contained in the conference committee report. In discussing the Commission's power to define terms in the NGPA, the Committee stated:

> the Commission may define terms such as "transfer for value" used in the definition of first sale; it may also establish rules applicable to intracorporate transactions under the first sale definition.

H.R.Rep. No. 95-1752, 95th Cong., 2d Sess. 116, *reprinted in* [1978] U.S.Code Cong. & Ad.News 8800, 9033. The Commission contends that this statement only suggests that the Commission may issue regulations defining an intracorporate transaction as a first sale, not that it is required to do so. We reach a different conclusion. This comment assumes that intracorporate transactions will fall within the first sale definition. The decision which Congress committed to the Commission's judgment was whether regulations were necessary to govern those transactions. The fact that the Commission was permitted to regulate intracorporate transactions under the first sale definition does not imply that Congress did not intend in the first instance for them to be treated as first sales.

Treating this transfer as a first sale would obviate the difficulties which prompted the Commission to promulgate Order No. 58. The Commission had been concerned that normally only a portion of a sale by a pipeline to its customers downline would be attributable to the pipeline's own production. Because only a portion of the sale, rather than the sale itself, would be attributable, the Commission reasoned that a sale downline could not be a first sale under the terms of the NGPA unless it were comprised exclusively of pipeline produced gas. However, treating the intracorporate transfer as a first sale would mean that that sale would be wholly attributable to the pipeline's production.

The Commission was also concerned that applying NGPA prices to sales to customers downline would supplant the state's traditional jurisdiction over retail sales by interstate pipelines, intrastate pipelines and local distribution companies. However, if the NGPA prices attached to the intracorporate transfer by the producer then the state's jurisdiction over retail sales would remain intact. The only change would be that the cost of the gas to the pipeline or distribution company would be the NGPA price. Jurisdiction to set the final retail charge would remain with the state. Although the retail price would reflect the NGPA cost of gas, that change is consistent with Congress' desire to establish a uniform price for producers of both intrastate and interstate gas.

Finally, the Commission was concerned that applying NGPA prices to the sale downline would disturb its traditional method of establishing the cost of gas sold by the pipeline. The Commission feared that the new downline sale price would be limited to the maximum NGPA price rather than reflecting its traditional costs-plus-a-reasonable-return methodology. This would create difficulty in factoring in the costs of operating and maintaining the pipeline. However, if the NGPA prices were applied to the intracorporate transfer, then the Commission's practice would
538 not be disturbed. ⊥ Treating the intracorporate transfer as a first sale would establish the "cost" of the pipeline's own production to the pipeline at NGPA prices, just as the cost of independently produced gas to the pipeline is calculated. This cost could then be factored in as a component of the pipeline's costs, precisely as the Commission has done under the cost-of-service method. This is in fact what the Commission proposed to do in Order No. 98 and what it had previously done when it applied area and national rates to both independent and pipeline production.

FERC, however, refused to treat this intracorporate transfer as a first sale because it maintained that no sale took place. FERC also noted that because no contracts govern the intracorporate transfer, certain administrative problems would result. Although the legislative history convinces us that Congress intended the intracorporate transfer to be treated as a first sale, we respect the Commission's determination that administration would be difficult. We note, however, that in Order No. 98 the Commission would apply NGPA prices to this same intracorporate transfer. This assures us that the Commission's authority to issue regulations to govern this area will enable it to overcome these difficulties.

V.

Relying on the language, purposes and history of the NGPA, we hold that Congress clearly intended for any production attributable to an "interstate pipeline, intrastate pipeline or local distribution company, or any affiliate thereof" to be accorded first sale status under the NGPA and that Congress contemplated that the intracorporate transfer of pipeline production to the pipeline would be treated as the first sale. We therefore vacate Order No. 58. Because we hold that the Commission lacked authority to set prices for interstate pipeline production under the NGA, we also vacate Order No. 98 without reaching the issues of arbitrary pricing raised here.[4]

Orders Nos. 58 and 98 are

VACATED.

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[4] Northwest Pipeline Corporation petitioned for review of the Commission's decision in Order No. 98 to terminate its "special circumstances exception," which would have allowed a pipeline producer to seek a higher price than the nationwide rate set by the Commission under the NGA. The effect of our holding with respect to Order No. 58 is that the price for pipeline production will now be set under the NGPA. The parties have noted in their briefs that there is an ongoing rulemaking on the subject of such special relief under the NGPA. The issue raised by Northwest is therefore not yet ripe for review.

APPENDIX F

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

Entered: February 17, 1981

Case No. 80-175-G-42T

PENNZOIL COMPANY, a corporation,
Vienna, Wood County.
In the matter of increased rates and charges.

HEARING EXAMINER'S DECISION

Procedure

On May 1, 1980, Pennzoil Company, a corporation, filed a new tariff designated Fifth Revised Sheet No. 14, superceding Fourth Revision of Original Sheet No. 14, P.S.C. W.Va. No. 1, stating increased rates and charges of approximately $1,979,704 for providing natural gas service to approximately 5,400 customers in Boone, Calhoun, Cabell, Clay, Doddridge, Gilmer, Harrison, Kanawha, Lewis, Lincoln, Logan, Marion, Marshall, Monongalia, Pleasants, Putnam, Ritchie, Roane, Tyler, Wetzel, Wirt and Wood Counties, to become effective on June 10, 1980.

By order entered on June 2, 1980, Pennzoil Company ("Pennzoil" or "Company") was made respondent to this proceeding and pending investigation, hearing and decision thereon, the aforesaid new tariff was suspended and the use of the rates and charges stated therein deferred until October 8, 1980, unless otherwise ordered by the Commission, to enable the Commission Staff to examine and investigate the supporting data filed with said new tariff

and to provide time for the Commission's Division of Accounts,
Finance and Rates to make a study and report
concerning the matters involved herein. It was further
ordered that if the case had not been finally decided at the
expiration of the aforesaid suspension period, such rates
and charges as applied for could not be placed into effect
until the respondent entered into a bond with surety approved
by the Commission in the amount of One Million
Nine Hundred Eighty Thousand Dollars ($1,980,000.00)
conditioned for the refund to the persons or parties entitled
thereto of the amount of the excess, if any, plus interest
thereon as shall be determined by the Hearing Examiner,
as required by *Chapter 24, Article 2, Section 4 of the Code*
2 *of West Virginia,* [illegible] as amended, and filed said bond with
the Executive Secretary of the Commission.

Subsequently, the matter was set for public hearing to be held on September 9, 1980, at which time and place the respondent was to appear and offer evidence in support of its aforesaid increased rates and charges and anyone interested could appear and make such objection thereto as they deemed proper. Public notice of the nature, date, place and time of the hearing was required to be given by Pennzoil by posting for public inspection a copy of the setting for hearing order in conspicuous places where bills for gas service are paid and by providing a Class II legal publication in each of the Counties that it serves.

Then by order entered on August 19, 1980, upon the motion of the Commission's Staff, the hearing scheduled for September 9, 1980, was cancelled and the hearing rescheduled on November 19, 1980. The Commission's Staff alleged that more time was needed to complete its review of the Company's application. Again, public notice of the nature, date, place and time of the rescheduled hearing was required to be given as hereinbefore described.

On October 9, 1980, the Hearing Examiner entered an order setting the rate of interest at fourteen percent (14%) on the bond to be given in this proceeding.

Public notice was given and the hearing was held as rescheduled on November 19, 1980. The applicant appeared by co-counsel, Goodwin & Goodwin by C. E. Goodwin, Attorney at Law, and by Patricia A. Curran. An intervenor, Mildred Gillenwater was represented by Raymond Crooks, Attorney at Law. The Commission's Staff was represented by J. Gordon Pennington, Attorney at Law of the Commission's Legal Division. Four protestants appeared and gave statements of protest in opposition to the increased rates and charges. They were:

Floyd Rice
Opha Tackett
Thurmon Wright
Mildred Gillenwater.

At the time of the hearing the case file contained approximately seven hundred and fifty written protests in the form of letters and petitions. During the pendency of the case, letters and petitions of protest continued to arrive. Before
the date of this order, almost five hundred ⊥ more written 3
protests had been received and lodged in the case file for non-evidentiary purposes.

On November 19, 1980, testimony was taken and evidence introduced, at the close of which this case was submitted to the Hearing Examiner for a decision, pending completion of the briefing schedule. On February 2, 1981, the Commission's Staff filed a motion for an extension of the briefing schedule until February 20, 1981. The motion was denied on that same day. It would have been impossible to grant the motion for an extension and enter the

Hearing Examiner's Decision in a timely manner. It was noted in the motion that J. Gordon Pennington was no longer employed by the Commission's Legal Division, and that Joseph A. Mancuso, Attorney at Law, had been assigned to the case. The briefing schedule was completed on February 13, 1981. The respondent's brief was filed on February 2, 1981. The Commission Staff's brief was filed on February 13, 1981. The Intervenor did not participate in the briefing schedule. The respondent chose not to file a reply brief.

Discussion of the Evidence Including Findings of Fact

For the purpose of this order, reference to the transcript will be by the initials of the testifying witness followed by the pertinent page of the transcript in this manner (BP, p. 0). (Exhibits will be referred to as marked and/or entered into evidence).

LIST OF CITED WITNESSES

MG — Mildred Gillenwater
SHD— S. H. Dickson
OT — Opha Tackett
JS — John Snyder
RS — Robert Seagraves
ELO— Edwin L. Oxley
FR — Floyd Rice
TW — Thurmon Wright
JAC— James A. Cruise

The Commission's Staff in its audit report took issue with Pennzoil on twenty-two items. The Company stipulated to the appropriateness of eighteen of the Staff's adjustments. (RS, pp. 111-112). The Commission's Staff after listening to the Company's accounting witness testify withdrew two of its adjustments and accepted the Company's calculation. (ELO, pp. 135-136). The remaining two issues to be resolved in the instant case are (1) Interest Expense and (2) Purchased Gas Cost.

Before discussing these two issues, however, certain issues were carried forward by the Commission from the last rate proceeding, Case No. 79-145-G-42T. In its final order,
affirming the Hearing Examiner's ⊥ Decision the Com- 4
mission ordered Pennzoil, in its next rate case to:

(1) File a statement of its security deposit policy.

(2) Indicate the extent of the increased costs associated with monthly meter reading and the results of a customer poll indicating whether or not the customers want monthly meter readings considering the increased per customer monthly cost of these readings.

(3) Be prepared to discuss the feasibility of billing only when meters are read if the Company chooses to continue reading meters bimonthly.

(4) Assure that each customer is informed of his or her right to appeal a disputed bill before the Company terminates service due to the nonpayment of an estimated bill.

(5) Alter the language of the Company's delayed payment penalty to reflect the Commission's current policy in this regard.

(6) Make available to the Commission an actual expense based determination of the cost of its natural gas production and gathering functions prepared according to generally accepted accounting practices.

(7) Present evidence to indicate that the costs arising from renegotiated gas purchase contracts should not be allocated to the oii or other operations of Pennzoil.

Other requirements (e.g. the making of customer refunds and the filing of revised tariffs) were placed upon the Company but will be more timely considered by the Commission as a direct follow-up to the last rate proceeding.

In response to these requirements, the Company took the following actions:

(1) *Security Deposit Policy.* The Company has chosen to refund all of its security deposits and will no longer require them in the future except in two instances. Security deposits will be required of customers who have been delinquent in paying their gas bills to the Company for a period in excess of 45 days within the last six years, or who have had their gas service disconnected for nonpayment. (JS, pp. 39-40, Resp. Post-Hearing Ex. No. 1, attached as Appendix A).

The Hearing Examiner finds this policy to be reasonable when read vis-a-vis Rule 4.02(1)(a) of the Commission's *Rules and Regulations for the Government of Gas Utilities,* and further that it removes the likelihood of undue discrimination in application.

5 (2) *Monthly Meter Reading.* The Company determined that the increased per customer monthly cost associated with monthly meter reading as opposed to bimonthly meter reading would be approximately $1.35. Pennzoil then polled its customers by a printing on the customers' monthly statement asking if the customer desired monthly meter reading considering its increased cost. By the day of hearing, approximately sixty percent of the customers had returned their bills with the questionnaire printed on it. The results were as follows:

		Percentage of Total Customers
Those desiring readings every month	790	14.6
Those desiring readings every other month	672	12.4
No preference	379	7
No response	1381	25.6

Considering that only twenty-five percent of the responding customers indicated a desire to have monthly meter reading, after being informed of the approximate increased cost of the readings, the Hearing Examiner cannot make a recommendation that the Company should incur the additional expense necessary to read the meters every month. While the Staff and the Intervenor asked many questions regarding the reasonableness of the estimated increased cost of providing monthly readings, the Examiner is of the opinion and finds that the estimated cost was a fair approximation. (JS, pp. 42-46; Resp. Ex. No. JS-1; RS, pp. 118-120).

3. *Bimonthly Billing.* Company witness Snyder testified that billing only every other month coincidentally with the bimonthly meter readings would create cash flow problems for this utility. He also felt that such a billing process might create an undue strain on some household budgets during the heating season. Snyder felt that collection problems would arise and service terminations would increase under such a procedure. The Hearing Examiner finds that these are valid observations and therefore cannot recommend that this Company be required to provide bimonthly billing. (JS, pp. 47-48).

4. *Appeal of a Disputed Bill.* The Company has informed its customers of their right to appeal any disputed bill to the Commission, whether estimated or actual, by printing this information on their termination notices. The 6 Hearing Examiner finds that this satisfies the concern originally expressed that a customer might be terminated for nonpayment of an estimated amount. (JS, pp. 48-49).

5. *Delayed Payment Penalty.* The Company incorporated the standard delayed payment penalty in its most recent tariff filing. This standard delayed payment penalty reflects current Commission policy in this regard. It should be noted that the Company has chosen to suspend the assessment of delayed payment penalties during this winter heating season to determine whether or not the imposition of the penalty is an effective means of encouraging prompt payment of account. The Company will not impose the penalty again until it has contacted the Commission. The Hearing Examiner finds that the Company has temporarily satisfied this requirement from Case No. 79-145-G-42T. (JS, pp. 50-52). However, if the Company should reinstate the penalty, it is reminded that the Commission has ordered it not to apply the penalty to an estimated bill when the customer has provided an actual reading and timely paid the actual amount owed.

6. *Production and Gathering Cost Study.* Also in Case No. 79-145-G-42T, the Commission ordered the respondent to make available to the Commission in the next rate proceeding an actual expense based determination of the cost of its natural gas production and gathering functions prepared according to generally accepted accounting practices. The Company prepared such a report and made it available to the Commission's Staff during its audit, but did not chose to introduce it as evidence in this proceeding by sponsoring it as an evidentiary exhibit. That document, as

well as others, was used as a basis for the Staff's parallel study. The Staff attempted to introduce the Company Study into evidence in this proceeding, but without a sponsoring witness to testify regarding its identification, authenticity, and accuracy, it is incompetent as evidence. The Company has not then properly responded to the prior order of the Commission. Therefore, the Hearing Examiner finds that the record in this proceeding contains no competent evidence establishing the actual natural gas production and gathering costs of Pennzoil. (JS, p. 52-53, SHD, pp. 148-149).

7. *Renegotiated Gas Purchase Contracts.* In Case No. 79-145-G-42T, an intervenor took the position that increased gas purchase costs ⊥ arising from renegotiated gas 7
purchase contracts should be allocated to the oil and/or other operations of Pennzoil. The Commission instructed the Hearing Examiner to carefully review this issue in the instant case. At the hearing, Pennzoil witness James A. Cruise testified that Pennzoil does not engage in mineral operations other than oil and gas; eighty-four percent of the total 263 contracts have been renegotiated; and the renegotiated gas purchase agreements do not provide for purchase of any commodity other than natural gas. The oil operations of Pennzoil did not benefit in any way from these renegotiations. The new contracts gave no new rights to Pennzoil with regard to coal and/or any other type of mineral production. (JAC, pp. 89-90, 101-102).

The basic differences between the old contracts, which dated back to the 1920's and 1930's, and the renegotiated contracts are:

Old Contracts	Renegotiated Contracts
(a) Gas was to be produced until economic limit was reached or to a level of 20 Mcf daily.	(a) Gas is to be produced as long as the well produces 5 Mcf daily.
(b) Fixed rate of between 14 to 22 cents per Mcf.	(b) Area rate provision for the pricing of the gas.
(c) No corresponding provision.	(c) Option to purchase well or lease if operator elects to abandon the lease.
(d) No corresponding provision.	(d) Control over the Btu level and content of the gas.

(JAC, pp. 90-96).

The first difference is important to Pennzoil's customers when one considers that seventy-six percent of the contracts involve wells delivering less than twenty Mcf per day. The Hearing Examiner finds that these renegotiated gas purchase contracts are consistent with the interests of Pennzoil's utility customers. Therefore, no allocation of the cost of renegotiating the contracts or of the renegotiated price should be allocated to oil and/or other Pennzoil operations.

Now, let's turn to the issues in the instant case.

Interest Expense

To determine the appropriate amount of the respondent's interest expense, the Commission's Staff divided the

gross plant of the utility operation of Pennzoil by the 8
total Company's gross plant.

	Gross Plant	
Utility Operation	$ 1,211,403	= .0384%
Total Company	$ 3,152,227,000	

The Staff then multiplied this percentage amount of the total Company's interest expense of $86,682,000 to calculate an allocated interest expense of $33,286. To this figure, the Staff added a $1,271 per books credit to arrive at a total interest expense of $34,557 for Pennzoil.

	Interest Expense
Total Company	$ 86,682,000
	.0384%
Allocated to the Utility	$ 33,286
Per Books Credit	1,271
	$ 34,557

The Staff felt this was proper because Pennzoil's total company is composed of both regulated and unregulated subsidiaries. Staff reasoned that if net plant were used it would be improper because unregulated companies would use depreciation factors different than those used by regulated industry. (Statement A, Schedule 5, Sheet 2 of 2, SHD, p. 143).

The Company, on the other hand, determined its interest expense by taking the "control balance"[1] as of the end of the test year and multiplying it by the total debt portion of the consolidated Company's capitalization ratio as of the end of the test year to approximate the capital provided by the consolidation by the incurrence of debt. This debt capital was then multiplied by the consolidation's weighted interest rate to arrive at the total interest expense of the utility operation.

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[1] Control balance was defined as total assets taken from the balance sheet, offset by the liabilities of accounts payable and customers' deposits.

Control Balance	$ 995,204
Debt Factor of Consolidated Company Debt-Equity Ratio	48%
Capital Provided by Debt	$ 477,698
Consolidated Company Weighted Average Interest Rate	11.66%
	$ 55,700

9 The Company argues that it is more equitable to consider all of the financial requirements of Pennzoil's utility operation rather than gross plant in determining the appropriate level of interest expense. The Company calculation considers the working cash allowance, materials and supplies, etc. Witness Seagraves testified that inclusion of all these financial requirements is proper, since this Company currently does not meet its cash flow requirements. (RS, p. 114; Resp. Ex. RS-1, Statement G, Page 3 of 7, Adj. No. 8).

Having stated the two positions, it is now necessary to examine the Staff argument more closely. Witness Dickson opposed the Company approach for two reasons. He felt that: (1) Use of net plant rather than gross plant could be misleading because of the difference in depreciation rates utilitized by regulated and non-regulated companies in the consolidation. Mr. Dickson's testimony in this regard might have been compelling if the Company had used a ratio of utility net plant to consolidated net plant. This, of course, assumes that unregulated companies would be freer to use accelerated depreciation to protect their income from taxation, than would a regulated company. Accelerated depreciation would reduce unregulated net plant of the consolidation rapidly, thereby distorting the relationship of utility net plant to consolidated net plant. This would have the effect of increasing assignable interest expense to the utility operation. However, the Company did not use such a ratio, but began its calculation from its balance sheet, not with a gross or net plant ratio.

Secondly, Dickson testifies that interest expense should be based upon plant and additions, not upon working capital. This argument is also weak considering that this utility is not meeting its cash flow requirements. One would be hard pressed to restrict the flow of dollar borrowed by the consolidation through only to capital expenditures and not to any other financial need of this utility.

For these reasons, and considering that the Commission has never rejected the Company's method of calculation in prior cases, the Hearing Examiner finds the interest expense calculation advanced by Pennzoil to be reasonable. (SHD, pp. 143-144; RS, pp. 114-115).

Purchased Gas Cost 10

This issue constitutes the only significant contested issue in this rate case. Based upon a test year ending December 31, 1979, the respondent, Pennzoil seeks to increase sales revenue by approximately $1,653,705 or by 103%. (Staff Ex. No. 1). This case immediately follows Case No. 79-145-G-42T which was finally decided on October 22, 1980, just four months ago. In that case, the Company increased its revenue by $344,727. Prior to that case, Pennzoil's rates had been fairly stable at 85 cents per Mcf since 1974. (See

Final Orders, Case No. 7569, dated July 1974; Case No. 9025, dated December 14, 1978; and Case No. 79-145-G-42T, dated October 22, 1980). Since December of 1978, the commodity rate for this utility has increased from 85 cents per Mcf to the current charge of $3.98 per Mcf now in effect under bond—a 368% increase within twenty-six months. During that same time period, consumers who consumed large volumes of gas lost the advantage of a declining block rate structure as the company went from a declining block rate to a single consumption rate. (Final Order, Case No. 9025).

While it appears that operation, maintenance and general administrative expenses may have increased generally since the last rate case, the respondent seeks to increase its purchased gas cost by $1,019,014 at going-level from $1,045,485 to $2,064,499. The Company produces approximately sixty percent of its gas, necessitating the purchase of the other forty percent. (JAC, p. 104). Of the $2,064,499 in increased purchased gas costs, the Company proposes that it will pay $505,327 at going-level to nonaffiliated suppliers at a rate of $1.65 per Mcf, and $1,019,014 to itself at a rate of $3.31 per Mcf, over twice the nonaffiliated rate. (Resp. Ex. RS-1, Statement A, Schedule 2, Statement G, Adj. 10).

By way of justification, the Company testifies that the $3.31 rate is a weighted average rate calculated under the appropriate provisions of the Natural Gas Policy Act of 1978. The rate reflects the February 1980 rate escalated to May 1980 rates, the date of the filing of this procedure.

The $3.31 rate is the rate received by Pennzoil when it sells gas to Consolidated Gas Supply Corporation and others. Pennzoil has complied with all of the procedural
11 and filing requirements to have the State of West Virginia qualify their wells and the Federal Energy Regulatory

Commission certify their wells to receive NGPA prices. (RS, pp. 116-117).

The Staff increased the respondents purchased gas expense from $1,045,485 by $549,520 to $1,595,005, or by $469,494 less than the Company. The Staff calculated Pennzoil's percentage of production gas by subtracting total purchased gas from total West Virginia volumes for resale. The production volume percentage of total volume for resale was 60.59%. This percentage was then applied to a Pennzoil Utility Division sales volume to determine the amount of produced gas sold to Pennzoil's West Virginia utility customers. That volume was then multiplied by a rate of $2.489 per Mcf. This rate was calculated by averaging the Company's actual purchased gas costs for the first seven months of 1980 and adding to that average rate of $1.681 per Mcf a 61 cent per Mcf gathering cost and a 19.8 cent per Mcf West Virginia B & O Tax adjustment. The gathering cost was calculated by making various adjustments to the gathering cost of 75.4 cents per Mcf set forth in the Company's Gathering Cost of Service Study. (Staff Ex. No. 1, Statement G, Sheet 4 of 7, Adj. 11; Staff Ex. A, Sheet 1 of 10; Staff Ex. B; and Staff Ex. No. 4, Attachment A). It is obvious that the Staff-determined gathering cost as well as the Company's gathering cost must fail because of the references to the Company's Gathering Cost of Service Study. The Company did not qualify it as competent evidence. The Staff in making its calculations relied upon the Company's Cost of Service Study to provide initial gathering and production expense figures, which the Staff then adjusted. (Staff Ex. A, Sheet 1 of 10). Ordinarily, this in itself would indicate that both the Company's and the Staff's gathering cost is unsupported by competent evidence and must fail. However, the Staff also compared the gathering cost which they calculated from the respondent's cost of service with gathering costs of four other West Virginia gas producing companies and found Pennzoil's rate to be comparable with the sixty-one cent (61¢) per Mcf. (Staff Ex. No. 3, pp. 4-5). The Hearing Examiner finds then that the Staff's gathering cost, based upon its comparability with similar costs of other companies, is reasonable.

What, then, should be the cost of purchased gas for
Pennzoil? Should it be $3.31 per Mcf because Congress
12 felt higher rates imposed ⊥ through the National Gas
Policy Act of 1978 would encourage exploration, production and conservation? Did Congress consider how its decision would impact a Pennzoil customer in West Virginia with a fixed and/or limited income as rates increased by 368% in two years?

It is necessary now to turn to the Natural Gas Policy Act of 1978 (NGPA) and explore its provisions to determine exactly what Congress was thinking and what impact, if any, the NGPA was expected to have on Pennzoil's customers.

Title VI of the Natural Gas Policy Act of 1978 entitled "Coordination with Natural Gas Act: Miscellaneous Provisions" removes numerous classifications of natural gas from the jurisdiction of the Federal Energy Regulatory Commission under the Natural Gas Act (NGA). Included are gas previously undedicated to interstate commerce, high-cost natural gas, new natural gas from the outer continental shelf, and new on shore production well gas. [NGPA, Title VI, Section 601(a)]. It is important to note that the applicability of the NGA was not removed from one important classification of natural gas—natural gas sales under existing intrastate contracts. Title VI also finds that any amount paid in any "first sale" of natural gas is deemed "just and reasonable" for purposes of Sections 4 and 5 of the Natural Gas Act, if such amount does not exceed the applicable maximum lawful price established under Title I of the NGPA. The NGPA defines "first sale" as "any sale of any volume of natural gas—

> (i) to any interstate pipeline or intrastate pipeline;
>
> (ii) to any local distribution company;
>
> (iii) to any person for use by such person;
>
> (iv) which precedes any sale described in clause (i), (ii), or (iii); and
>
> (v) which precedes or follows any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act."

[NGPA, Section 2(21)].

A literal reading of this definition would lead to the
conclusion that the sales of Pennzoil gas to the utility customers, as well as production gas sales to Pennzoil, fall
within (ii), (iii) and/or (iv) and ⊥ are thus first sales. 13
However, there is much confusion over the definition of first sale at this time.

The FERC has recently promulgated regulations intended to explain the terms "first sale", FERC *Final Regulations,* Docket No. RM80-7, Order No. 58 issued November 14, 1979. "First sale" has been given a narrow construction:

> If a pipeline were to sell its production at the wellhead, in an off system sale, such a sale would generally qualify under § 270.203(a) as a first sale.

> . . ., however, sales by pipelines usually do not occur at the wellhead. Pipeline sales generally occur at the point the natural gas is withdrawn from the pipeline's general system supply. Furthermore, pipelines usually commingle the gas they produce with gas purchased from other sources and sell such mixed volumes without regard to the source of the particular volumes of natural gas involved. The Commission is aware that, as a result, most sales by interstate pipelines will not qualify as first sales under § 270.203(a) because the volumes sold are not produced exclusively by and identifiable to the pipeline's own production. (FERC Order No. 68, at 2-4).

But for the fact that Pennzoil must meet the gas demands of its utility customers in West Virginia, all its produced gas would be sold in interstate commerce. Pennzoil admits that it is a combined producer distributor. (JAC, pp. 98-99).

A reasonable interpretation of FERC Order No. 58 *(supra)* is that when a gas company both produces and purchases gas "from other sources" and then sells the mixed volumes to customers, such gas is commingled. Because this commingled gas cannot be identified with the gas company's own production, the order states that a sale of this type of gas "will not qualify" as a first sale.

Section 105 of Title I of the NGPA is entitled "Ceiling Price for Sales Under Existing Intrastate Contracts", and provides that the maximum lawful price for this category of natural gas *shall be the lower of* either (1) the price under the terms of the contract in existence on November 9, 1978[1], or (2) the price per million Btu's computed elsewhere under the NGPA. Considering the fact that most, if not all, of Pennzoil's production dates back to the 1920's and 1930's, the contract price would ⊥ probably be con- 14 trolling. Some of the contracts have been renegotiated, however, to an adjusted NGA "area rate."

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[1] The NGPA of 1978 was enacted on this date.

Under that portion of Title I, which controls the application of the NGPA's general price ceiling rules, Congress declared that any price established under contract for the first sale of natural gas and which does not exceed the applicable lawful price under Title I, shall be controlling. Congress felt that no seller should receive a higher price than his contract permits. [NGPA, Title I, Section 101(b)(9); NGPA Joint Explanatory Statement of the Committee on Conference].

The only contract in evidence in this proceeding is respondent's Exhibit JAC-2. A reading of Article VI of that contract will indicate that the price agreed upon is twenty-four cents (24¢) per Mcf or an alternative rate based upon an "area rate".

In *Independent Oil & Gas Association of West Virginia,* 10 FERC 61, 214 (March 4, 1980), the FERC explicitly stated that a contract must include the NGPA rates:

> The starting point for analysis is the text of the contract. If the price escalator clause expressly permits collection of statutory or legislatively established rates, the Commission will, of course, permit sellers to charge and collect NGPA rates.
>
> (10 FERC at p. 61, 398).

On September 23, 1980 and December 10, 1980, a FERC Administrative Law Judge entered his initial decisions in Consolidated Docket RI74-188 and 75-21. In those consolidated cases, the ALJ found that the proper pricing mechanism for old gas was to apply the area rate adjusted for inflation. He applied the NGPA rates only to new gas. If Pennzoil were entitled to levy the NGPA rates, then the IOGA rates would be superseded. However, since Pennzoil has not shown contractual entitlement to the NGPA rates but to IOGA or area rates, its argument that NGPA supersedes IOGA pricing regulation must fail.

The Natural Gas Policy Act of 1978 (NGPA) started out as Part 4 of H. R. 8444, the National Energy Act. It was to establish a single uniform price policy for natural gas produced in the United States. It imposed Federal price controls on the intrastate market for the first time. The natural gas pricing policy legislation passed by the United States Senate was an amended version of S. 2104, the
15 Natural Gas Policy ⊥ Act. The Senate passed bill embodied a significantly different approach to the natural gas pricing policy issue than that adopted by the United States House of Representatives—flowing intrastate natural gas was not to be regulated by the Federal government. The conference committee reported out a reconciled bill which became the Natural Gas Policy Act of 1978. That Act established rates for natural gas produced in the United States, but with certain exceptions and variations. (See Joint Explanatory Statement, *supra*).

The FERC is of the opinion that at least to commingled gas streams (i.e. purchased and produced gas), and only to commingled gas streams, where a state regulatory agency has pricing authority, there is no reason for the FERC to assert jurisdiction.[1] (FERC General Order 102 dated October 3, 1980).

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[1] Pennzoil's gas supply is commingled in this fashion. (JAC, p. 104).

The FERC's position reflects the policy set forth in Section 602 of the NGPA. Entitled "Effect on State Laws", paragraph (a) of this Section authorizes the several states to prescribe lower maximum lawful prices. It reads:

> "Nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under Title I of this Act."

The Joint Explanatory Statement of the NGPA indicates that Congress was ceding its authority under the commerce clause of the constitution to regulate prices for such production to affected States. It appears that all other arguments now become academic. Regardless of whether Title VI, Section 601(b)(1); Title I, Section 105(b); or Title I, Section 101(b)(9) is the controlling authority for the pricing of Pennzoil's gas at contract or area rates, the State of West Virginia is authorized to set prices lower than NGPA prices, if it chooses to do so. The West Virginia Legislature has stated that:

> "It is the purpose and policy of the legislature . . . to confer upon the public service commission of this State the authority and duty to enforce and regulate the practices, services and rates of public utilities in order to . . . (e) insure that rates and charges for utility services are just, reasonable, applied without unjust discrimination or preference and based primarily on the costs of providing these services . . ." [*West Virginia Code*, § 24-1-1(a)(4)].

More specifically, the Commission's authority over practices and rates of the respondent gas utility is found in *Code*, § 24-2-1, § 24-2-2, § 24-2-3, § 24-2-4, and § 24-2-7. 16

It is in the exercise of this authority that the Hearing Examiner finds that the Commission must, whenever possible, look to the actual cost, not an artificially inflated cost of natural gas, to determine reasonable rates for the consumers of Pennzoil.

In summary, it appears that Congress did consider Pennzoil's customers in West Virginia when it passed the Natural Gas Policy Act of 1978. Congress has decided that existing contract prices should prevail, and has left the determination of those prices within the jurisdiction of the Public Service Commission of West Virginia. Using the current area rate of 1.3945 added to the gathering cost of 61 cents, instead of using the requested NGPA rate of $3.31 will reduce the annual revenue requirement of this utility by approximately Nine Hundred Thousand Dollars ($900,000.00).

Ultimate Findings of the Hearing Examiner Including Conclusions of Law

For all these reasons hereinbefore discussed the Hearing Examiner is of the opinion and finds that the current area (IOGA) rate is a reasonable and proper rate for the determination of Pennzoil's purchased gas cost. There is nothing in the record to convince the Hearing Examiner that the Commission should depart from its previous position that the pricing of Pennzoil's purchased gas at the IOGA rate is reasonable.

The rates designed in these proceedings will generate a rate of return of fourteen percent. This return may appear excessive, but the Examiner feels that it is still a reasonable level of earnings considering the estimated $235,000 in estimated additions to capital plant by December of 1980, and the $350,000 in budgeted capital additions of 1981.

(RS, pp. 117-118). Looking at the magnitude of these expenditures in relation to the $619,766 average rate base reflected in Staff Exhibit No. 1, the Hearing Examiner finds that the 1979 year end rate base should be used in the cost of service calculation.

It is also noted that the Staff did not challenge a $100,000 home office expense allocation in this proceeding, which the respondent had ⊥ not been carrying per books. 17
In any subsequent proceeding, the respondent should be prepared to demonstrate by competent evidence the allocation methods and amounts of allocated home office expense used in its most recent filings or administrative proceedings in each of the regulatory environments within which it operates, so that it can be determined that its West Virginia utility customers are bearing no more than their fair share of these expenses.

ORDER

1. The rates and charges contained in Fourth Revision of Original Sheet No. 14 of P.S.C. W.Va. No. 1, are unreasonable and unjust in that they do not generate sufficient revenue for Pennzoil to pay its reasonable and necessary operating expenses, to pay its taxes, to earn a fair rate of return on investment, and to finance necessary capital improvements.

2. The rates and charges contained in Fifth Revision Sheet No. 14 of P.S.C. W.Va. No. 1, and placed into effect, subject to refund, on or about October 8, 1980, are unreasonable and excessive in that they will generate revenue in excess of that needed for the purpose set forth in Paragraph 1.

3. The rates and charges set forth in Appendix B are authorized and approved as just and reasonable in that they

will produce no more revenue than is necessary for the purpose set forth in Paragraph 1 for the period beginning October 8, 1980.

4. The respondent, Pennzoil Company, shall within thirty (30) days of the date on which this order becomes final, file its tariffs with the Commission containing the approved and authorized rates and charges as hereinafter set forth.

5. The respondent shall refund to each of its customers within sixty (60) days of the date this order becomes final, the difference between the amounts collected under Fifth Revised Sheet No. 14 of P.S.C. W.Va. No. 1, and the rates and charges approved in Appendix B, with interest at the rate of fourteen percent (14%) per annum for the period beginning October 8, 1980 to the date of refund, and shall promptly report such refunds and the method of calculation to the Commission.

18 The Executive Secretary is hereby ordered to serve a copy of this order upon the Commission by hand delivery, and upon all parties of record by United States Certified Mail, return receipt requested.

Leave is hereby granted to the parties to file written exceptions supported by a brief with the Executive Secretary of the Commission within fifteen (15) days of the date this order is mailed. If exceptions are filed, the parties filing exceptions shall certify to the Executive Secretary that all parties of record have been served said exceptions.

If no exceptions are so filed this order shall become the order of the Commission, without further action or order, five (5) days following the expiration of the aforesaid fifteen (15) day time period, unless it is ordered stayed or postponed by the Commission.

Any party may request waiver of the right to file exceptions to a Hearing Examiner's Order by filing an appropriate petition in writing with the Secretary. No such waiver will be effective until approved by order of the Commission, nor shall any such waiver operate to make any Hearing Examiner's Order or Decision the order of the Commission sooner than five (5) days after approval of such waiver by the Commission.

/s/ C. Terry Owen
C. TERRY OWEN
Hearing Examiner

Date: February 17, 1981

APPENDIX A

PENNZOIL COMPANY
COST OF SERVICE
Case No. 80-175-G-42T

	14% *Return* $
Operation & Maintenance Expense	1,505,379
Depreciation	63,573
Other Taxes	110,867
Federal Income Tax	40,788
Credits to Cost of Service	(5,173)
Allowance for Return (Rate Base—814,077)	113,971
	1,829,405
Going-Level Revenue	1,608,460
Deficiency Before Additional B & O Taxes (4.29)	220,945
Additional B & O Taxes	9,903
Total Deficiency Under Present Rates	230,848
Revenue Increase Under Proposed Rates	1,653,705
Excess of Increase Over Deficiency	1,422,857
Calculation of Tax (A)	
Allowance for Return	113,971
Less: Deductions for Tax Purposes	(33,004)
Total (C)	80,967
Tax (C ÷ 66.5%)	121,755
Less: Total C	80,967
F.I.T.	40,788

APPENDIX B

PENNZOIL COMPANY

Case No. 80-175-G-42T

AUTHORIZED RATES

AVAILABILITY OF SERVICE

Available for the requirements of any authorized applicant on basis of eight ounce (8 oz.) pressure.

RATE

One (1) Mcf and greater used through each meter each month—$2.415 per Mcf.

DELAYED PAYMENT PENALTY

The above schedule is net. On all accounts not paid in full within twenty (20) days of the date of bill, three (3) cents per Mcf will be added to the net amount shown. This delayed payment penalty is not interest and is only to be collected once for each bill where it is appropriate.

MINIMUM MONTHLY CHARGE

The minimum charge per month per customer shall be $5.00 which charge shall be in addition to the amount charged per month per Mcf used. There shall be no offset or credit against said monthly minimum monthly charge for any amounts charged for Mcf used.

The above rates include a purchased gas cost of .953¢ per Mcf approved by order of the Commission dated October 31, 1980, in Case No. 80-330-G-30C.

APPENDIX G

STATE OF WEST VIRGINIA
IN THE SUPREME COURT OF APPEALS

In Vacation

Pennzoil Company, a corporation

vs.

The Public Service Commission of West Virginia

This day came the petitioner, Pennzoil Company, a corporation, by Patricia A. Curran and C. E. Goodwin, its attorneys, in the vacation of the Court and moved the undersigned Justices to stay and suspend the order of the respondent, Public Service Commission, entered September 10, 1981, in Commission case No. 80-175-G-42T, requiring payment of certain refunds, pending petitioner's application for appeal or certiorari to the Supreme Court of the United States from the order of this Court, entered December 10, 1981, denying petitioner an appeal therefrom. And, a majority of the undersigned Justices being of opinion that said motion should be granted, it is, therefore, considered and ordered that enforcement of the order of the Public Service Commission entered September 10, 1981, in Commission Case No. 80-175-G-42T be, and the same is hereby, stayed until March 10, 1982, or until such time as petitioner's application to the United States Supreme Court is finally determined. Justice McGraw would deny said Motion.

Done In Vacation of the Supreme Court of Appeals, this 22nd day of December, 1981.

Thomas B. Miller
Darrell V. McGraw, Jr.
Thomas E. McHugh
Justices of the Supreme Court of Appeals

Received the foregoing order this 22nd day of December, 1981, at two o'clock p.m., and entered the same in Order Book No. 84.

George W. Singleton
Clerk Supreme Court of Appeals

A True Copy

Attest: /s/ George W. Singleton
Clerk Supreme Court of Appeals

APPENDIX H

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Abandonment Certificate

Before Commissioners: Charles B. Curtis, Chairman;
Georgiana Sheldon, Matthew Holden, Jr.,
George R. Hall and J. David Hughes.

Docket No. G-7004
PENNZOIL COMPANY

FINDING AND ORDER AFTER STATUTORY HEARING PERMITTING AND APPROVING ABANDONMENT OF SERVICE

(Issued November 24, 1980)

On November 30, 1976, Pennzoil Company (Pennzoil) filed an application[1] for amendment of its certificate issued in Docket No. G-7004, in order to make its certificate consistent with its replacement contract, executed August 19, 1976, with Consolidated Gas Supply Corporation (Consolidated). Pennzoil seeks to delete 75,886.5 acres of the 505,427 acres covered by the above-mentioned certificate. Pennzoil alleges that the above-mentioned 75,886.5 acres are generally non-productive and are generally empty of any known gas reserves.

Prior to filing for its certificate to sell gas to Consolidated, Pennzoil executed with Consolidated a gas sales contract on April 10, 1930 which was subsequently designated as Pennzoil Company FERC Rate Schedule No. 10. This contract dedicated all gas produced or purchased by

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[1] Pennzoil amended its application on October 20, 1977 and filed additional information regarding the application on July 10, 1978 and September 5, 1979.

Pennzoil in West Virginia, including gas produced in West Virginia in which Pennzoil acquired an interest after April 10, 1930.

2 After receiving its certificate covering the sale of the the subject gas to Consolidated, Pennzoil filed applications for additional certificates, notwithstanding this gas was already dedicated to Consolidated, which would cover the gas produced from a portion of the acreage that Pennzoil seeks to delete from its certificate. Pennzoil has been selling gas to other interstate pipelines or domestic consumers, despite the fact that such gas is still dedicated to Consolidated under the certificate issued in Docket No. G-7004.

The August 19, 1976, replacement contract[2] limits dedication to all gas purchased by Pennzoil in West Virginia, all gas produced by Pennzoil from all producing property in West Virginia owned or leased by Pennzoil as of August 19, 1976, and all gas produced by Pennzoil from all nonproducing properties owned or leased by Pennzoil as of August 19, 1976, within 2½ miles of Consolidated's existing pipeline system in West Virginia, except gas produced from properties dedicated to prior sales agreements. Pennzoil proposes to amend its certificate to delete all of its nonproducing acreage more than 2½ miles from Consolidated's existing pipeline system in West Virginia and acreage which Pennzoil may acquire in West Virginia in the future. Pennzoil states that the 1930 contract covered 505,427 acres and the replacement contract covers 429,540.5 acres—a difference of 75,886.5 acres.

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[2] The replacement contract was accepted for filing as Supplement No. 29 to Pennzoil's FERC Gas Rate Schedule No. 10 as a rate schedule filing only and not as constituting authorization under Section 7(b) of the Natural Gas Act.

Pennzoil states that of the 75,886.5 acres which it proposed to delete, 72,618 acres are currently non-productive and contain no known gas reserves. Of the remaining 3,268.5 acres, 1,489 of these acres have known gas reserves which are not being produced,[3] 1,401 of the acres have gas production which is being sold to other interstate pipelines pursuant to certificate authorization, and 378.5 of the acres have gas which is being sold to domestic consumers as permitted by the 1930 contract.

On December 16, 1976, the subject application was noticed. Consolidated intervened, stating that it does not oppose the proposed deletion. 3

Pennzoil should have filed for partial abandonment of the acreage covered by its certificate in Docket No. G-7004 at the time it applied for certificate authorization to sell gas to other interstate pipelines and prior to the commencement of deliveries of gas from such acreage to domestic consumers. Pennzoil should not make sales to new purchasers in the future from acreage covered by Docket No. G-7004 in the absence of Commission abandonment authorization. This order should not be construed as doing anything other than bringing Pennzoil into prospective compliance with the Natural Gas Act. The Commission is not in any way passing on what has occurred prior to this date.

In keeping with the principles announced in our order in *Belco Petroleum Corporation, et al.*,[4] we believe, with respect to the non-productive acreage, that deletion of such acreage should be granted. Moreover, we shall grant deletion of the requested productive acreage since deletion is permitted by the public convenience and necessity because: (a) other interstate purchasers or high priority domestic consumers will continue to utilize the gas; and (b) Consolidated agrees to the deletion.

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[3] Pennzoil states that this acreage is part of a gas recycle unit and that the gas under this acreage is in the gas cap of the recycle unit. Production of this gas would permit oil migration to the gas cap and affect oil recovery from the project.

[4] *Belco Petroleum Corporation, et al.*, Docket No. CI69-91, *et al.*, order issued December 20, 1979.

At a hearing held on November 19, 1980, the Commission on its own motion received and made a part of the record in this proceeding all evidence, submitted in support of the authorization sought herein, and upon consideration of the record.

The Commission finds:

(1) Applicant herein is a "natural-gas company" within the meaning of the Natural Gas Act as heretofore found by the Commission.

(2) The sale of natural gas proposed to be abandoned, as hereinbefore described and as more fully described in the application, is subject to the requirements of subsection (b) of Section 7 of the Natural Gas Act.

(3) It is necessary and appropriate in carrying out the provisions of the Natural Gas Act and the public convenience and necessity require that the order issuing certificate of public convenience and necessity involved herein should be amended as hereinafter ordered.

4 (4) The abandonment proposed by Applicant herein is permitted by the public convenience and necessity and should be approved as hereinafter ordered.

(5) It is necessary and appropriate in carrying out the provisions of the Natural Gas Act that the FERC gas rate schedule supplement related to the authorization hereinafter granted should be accepted for filing.

(6) Participation by the intervenor in this Docket may be in the public interest.

The Commission orders:

(A) The order issuing the certificate of public convenience and necessity in Docket No. G-7004 is amended to permit the partial abandonment of service, all as more fully described in the application to amend. In all other respects such order shall remain in full force and effect.

(B) The rate schedule supplement related to the authorization granted herein is accepted for filing, as Supplement No. 1 to Supplement No. 29 to Pennzoil Company FERC Gas Rate Schedule No. 10.

(C) In accordance with the Natural Gas Policy Act of 1978 (NGPA), since the natural gas from the acreage involved was "committed or dedicated" to interstate commerce on November 8, 1978, any subsequent sale therefrom may not be made at a rate in excess of the lesser of the contract rate or the maximum lawful rate prescribed in section 104 of the NGPA unless, the producer obtains special relief or the gas qualifies for a higher rate under another section of the NGPA and (1) there is compliance with the Part 273 interim collection procedure, (2) a final determination has been made by the jurisdictional agency under Part 274, or (3) a final non-appealable action has been taken by the Commission in accordance with Section 275.202 of the regulations relating to section 503(e) of the NGPA.

(D) Consolidated is permitted to intervene subject to the Rules and Regulations of the Commission, *Provided, however,* that the participation of such intervenor shall be limited to matters affecting asserted rights and interests as specifically set forth in its petition to intervene; and *Pro-* 5 *vided, further,* that the admission of said intervenor shall not be construed as recognition by the Commission that it might be aggrieved because of any order of the Commission entered in this proceeding.

By the Commission.

(SEAL)

/s/ Kenneth F. Plumb
KENNETH F. PLUMB,
Secretary.

CERTIFICATE OF SERVICE

I hereby certify that I have served three copies of this Appendix to Petition for a Writ of Certiorari on:

Robert R. Rodecker
General Counsel
Public Service Commission of
West Virginia
State Capitol
Charleston, West Virginia 25305

who is the only party required to be served, by first class mail, postage prepaid, this 10th day of March 1982.

/s/ KIRK K. VAN TINE

KIRK K. VAN TINE
Attorney for
PENNZOIL COMPANY

Supplemental Brief

Office - Supreme Court, U.S.
FILED
SEP 24 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1672

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

PENNZOIL COMPANY,
Petitioner,
v.
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

SUPPLEMENTAL BRIEF OF PENNZOIL COMPANY

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TABLE OF CONTENTS

Page

ARGUMENT 2

A. A Remand to the West Virginia Court for Clarification is Unnecessary 2

B. No Reason Exists to Defer Consideration of This Case. 4

C. The Memorandum Incorrectly Characterizes the Question of the Power of the States Under Section 602 of the NGPA 7

CONCLUSION 10

TABLE OF CITATIONS

Cases

Page

Illinois v. *Vitale*, 447 U.S. 410 (1980) 4

Michigan v. *Peques*, 452 U.S. 934 (1981) 4

Mid-Louisiana Gas Co. v. *FERC*, 664 F.2d 530 (1981) *reh'g denied*, 669 F.2d 729 (5th Cir. 1982), *petitions for cert. filed*, Nos. 81-1899, 81-1958, 81-2042 and 82-19 ...... 2, 3

Percy v. *Terry*, 434 U.S. 808 (1977) 4

Virginia Electric & Power Co., 242 S.E.2d 698 (W. Va. 1978). 3

Williams v. *Kaiser*, 323 U.S. 471 (1945) 3

STATUTES

Natural Gas Policy Act of 1978,
  Section 2(21), 15 U.S.C. § 3301(21) 4
  Section 602(a), 15 U.S.C. § 3432(a) 5, 7, 8, 9

ADMINISTRATIVE ORDERS

FERC Order No. 58, 44 Fed. Reg. 66,577 (1979) 5

No. 81-1672

IN THE

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PUBLIC SERVICE COMMISSION
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ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

SUPPLEMENTAL BRIEF OF PENNZOIL COMPANY

On May 3, 1982, the Court issued an Order in this case inviting the Solicitor General to file a memorandum expressing the views of the United States. On July 28, 1982, the Solicitor General and the Federal Energy Regulatory Commission (FERC) filed a Memorandum as amici curiae in response to that Order. Pursuant to Rule 22.6 of the Rules of this Court, Pennzoil Company (Pennzoil) files this Supplemental Brief to respond to certain matters raised for the first time in the Memorandum of the Solicitor General and the FERC.

ARGUMENT

Pennzoil believes that the Memorandum does not accurately summarize the facts or objectively evaluate the issues presented by this case. Instead, it appears that the views presented in the Memorandum are intended to ensure that the Court does not take action adverse to FERC's litigating position in a related case filed after Pennzoil's Petition.[1]

A. A Remand to the West Virginia Court for Clarification Is Unnecessary.

The Memorandum asserts that "there is a substantial question in this case whether the judgment of the West Virginia Court rests on an independent and adequate state ground." Memorandum at 5. Based on that assertion, the Memorandum suggests that the Court may wish to remand the case for clarification. *Id.* The Memorandum contains no analysis of the alleged state grounds, however, and even a cursory examination of those grounds reveals that they both are patently frivolous.[2]

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[1] As Pennzoil explained in its Petition for Certiorari at 16-17, the decision of the West Virginia Supreme Court of Appeals conflicts with the opinion of the U.S. Court of Appeals for the Fifth Circuit in Mid-Louisiana Gas Co. v. FERC, 664 F.2d 530 (5th Cir. 1981). On July 6, 1982, almost four months after Pennzoil filed its Petition for Certiorari in this case, the FERC filed a petition for certiorari seeking to overturn the Fifth Circuit's decision. FERC v. Mid-Louisiana Gas Co., No. 82-19. The courses of action suggested by FERC in the Memorandum filed in this case would prevent Pennzoil from presenting any further argument until after the Court disposes of *Mid-Louisiana.*

[2] Pennzoil reviewed the lack of merit of the alleged state grounds in its original Reply Brief at 2-4.

The first alleged ground, that Pennzoil should have requested rehearing before seeking judicial review, is not only inadequate—it is in fact non-existent. There is no mention anywhere in the Rules of the Public Service Commission of West Virginia or the laws of the State of West Virginia of a requirement to seek rehearing of an order of the Public Service Commission before seeking judicial review.

The second alleged ground, that the West Virginia Court could have relied on its previous decision in *Virginia Electric & Power Co.,* 242 S.E.2d 698 (W. Va. 1978), inherently would have required a conclusion by the West Virginia Court either that the NGPA was not applicable, or that it does not preempt the action taken by the Public Service Commission. Those are precisely the underlying federal questions Pennzoil asserts were decided incorrectly. If the West Virginia Court did in fact rely on *Virginia Electric,* then it must have decided the federal questions adversely to Pennzoil.

Where it is improbable that the state court could have legitimately relied on the alleged state ground, past decisions of this Court indicate a strong presumption against inferring such reliance. "[I]t is . . . well settled that if the independent ground was not a substantial or sufficient one, 'it will be presumed that the state court based its judgment on the law raising the Federal question, and this court will then take jurisdiction.'" *Williams* v. *Kaiser,* 323 U.S. 471, 478 (1945) (citations omitted).

In this case, where the federal questions presented are significant, and the possibility that the West Virginia Court relied on state grounds is extremely slight, the applicable precedent indicates that the Court need not remand the case for clarification. A remand would do little to enhance the record before the Court, and would needlessly delay the resolution of the important questions presented by Pennzoil's Petition.[3]

B. No Reason Exists to Defer Consideration of This Case.

The Memorandum filed by the FERC and the Solicitor General suggests that the Court should defer consideration of this case pending disposition of the petitions for certiorari seeking review of the decision of the Fifth Circuit in *Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530 (5th Cir. 1981). Memorandum at 5. In making that suggestion, the Memorandum relies on several incorrect assumptions regarding the nature of the issues presented in Pennzoil's case.

First, the Memorandum incorrectly assumes that the issues presented in this case are dependent on the outcome of the issues presented in *Mid-Louisiana*. Memorandum at 5-6. While Pennzoil has asserted that the conflict between the Fifth Circuit's decision and the decision of the West Virginia Supreme Court of Appeals is one ground for granting certiorari, Pennzoil also asserts that, because of the facts relevant to its West Virginia operations, the prices prescribed by the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3301 *et seq.*, are applicable to the gas produced by Pennzoil, regardless of the ultimate disposition of *Mid-Louisiana*. The dispute between Pennzoil and the Public Service Commission of West Virginia would continue even if *Mid-Louisiana* were reversed, because

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[3] In any event, even if this Court decides that further clarification is necessary, the Court should proceed in accordance with its recent practice, and should not only remand but also vacate the decision of the West Virginia Supreme Court of Appeals. *See* Michigan v. Peques, 452 U.S. 934 (1981); Illinois v. Vitale, 447 U.S. 410 (1980); Percy v. Terry, 434 U.S. 808 (1977).

FERC Order No. 58, which the Fifth Circuit vacated in *Mid-Louisiana*, contained two provisos, both of which are applicable to the facts of Pennzoil's case. Under either, or both, of those provisos, Pennzoil's sales are "first sales" eligible for NGPA prices.[4]

Second, contrary to the assertions made in the Memorandum, the questions presented by West Virginia's interpretation of Section 602(a) of the NGPA are entirely separate from the questions relating to the proper interpretation of the term "first sale" in Section 2(21) of the NGPA. If *Mid-Louisiana* is upheld, then the "first sale" issue will have been resolved favorably to Pennzoil, but the question of the scope of Section 602(a) will remain. If *Mid-Louisiana* were reversed and FERC Order No. 58 were reinstated, two questions would be presented: (1) whether West Virginia improperly interpreted and applied Order No. 58 to Pennzoil, and (2) whether West Virginia correctly interpreted Section 602(a).

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[4] In Order No. 58, the FERC recognized that sales of gas occurring before produced gas is mixed with purchased gas are "first sales" under the NGPA. Because of the unique configuration of Pennzoil's producing, gathering, transportation and distribution systems in West Virginia, Pennzoil's produced gas in many instances is not mixed with purchased gas before being sold. Therefore, with respect to many of Pennzoil's sales to West Virginia customers, the gas sold is "attributable" to Pennzoil's own production, even under the FERC interpretation of "first sale" vacated by the Fifth Circuit in *Mid-Louisiana*. In addition, Order No. 58 provides that sales of volumes of gas dedicated from particular sources to particular customers will be considered "first sales" even if volumes of produced and purchased gas are mixed before the sales occur. In Pennzoil's case, the West Virginia Commission has ordered Pennzoil to supply volumes of gas to West Virginia customers, resulting in a dedication of the amount of Pennzoil's produced gas required to serve those customers. Thus, again, even under the FERC rules vacated in *Mid-Louisiana*, Pennzoil's sales to West Virginia customers qualify as "first sales" under the NGPA.

Pennzoil maintains that no good reason exists to postpone consideration of its Petition. The issues raised by the Petition are sufficiently meritorious and distinct from those in the petitions regarding *Mid-Louisiana* that they eventually will require resolution regardless of the outcome of that case. Accordingly, considerations of judicial efficiency suggest that *Mid-Louisiana* and this case should be treated as companion cases.

In any event, even if the Court considers this case and *Mid-Louisiana* to be interdependent, the Court should not defer consideration of Pennzoil's case. The petitions for certiorari seeking review of *Mid-Louisiana* present only arguments regarding the theoretical impact of that decision. None of those petitions, including the petition filed by the FERC, quantifies a certain, provable, current impact caused by the decision. In contrast, Pennzoil's petition in this case presents a concrete test of the practical application and effects of *Mid-Louisiana*.

In addition, the petitions for certiorari in *Mid-Louisiana* discuss only one facet of that case: the potential impact of *Mid-Louisiana* on consumers who buy gas from interstate pipelines. In contrast, Pennzoil's case demonstrates the practical application of *Mid-Louisiana* to a local distribution company subject to state regulation. In that context, the primary issue in Pennzoil's case is the proper relationship between the NGPA as interpreted by *Mid-Louisiana* and regulation by state utility commissions. Full briefing and argument of the issues presented by this case could complement the Court's understanding of the full impact of the *Mid-Louisiana* decision by demonstrating the application of that decision in the intrastate context. With regard to the issues presented by *Mid-Louisiana*, Pennzoil represents a position not represented by any of the petitioners in that case and is able to present facts and arguments that none of those petitioners are able to present. Thus, if the Court determines that this case is inseparable from *Mid-Louisiana,* then the proper course of action is not to defer consideration of this case, but to permit Pennzoil to brief and argue this case concurrently with the petitioners in *Mid-Louisiana.*

C. The Memorandum Incorrectly Characterizes the Question of the Power of the States Under Section 602 of the NGPA.

The Memorandum mistakenly asserts that Pennzoil's challenge to the Public Service Commission's authority under Section 602(a) of the NGPA is dependent on the outcome of the interpretation of "first sale" at issue in *Mid-Louisiana.* Memorandum at 5. As explained above, however, Pennzoil asserts that, regardless of the outcome in *Mid-Louisiana,* the prices established by the NGPA are applicable to its gas produced in West Virginia. Thus, the question of the proper interpretation of Section 602(a) of the NGPA will remain for decision by this Court regardless of the outcome of *Mid-Louisiana.*

In addition, the Memorandum mischaracterizes the basis of Pennzoil's argument regarding Section 602(a). The Memorandum asserts that the Section 602(a) issue "is based on the proposition . . . that the sales of gas to [Pennzoil's] retail customers in West Virginia take place 'in interstate commerce' because that gas is commingled with gas sold to interstate pipelines for resale in interstate commerce." Memorandum at 6. The Memorandum further asserts that the question of whether the transactions at issue are "in interstate commerce" is a "fact-bound" question, and that this Court should not attempt to resolve that question. *Id.* These assertions simply are not correct.

First, contrary to the statement in the Memorandum, the question of state authority under Section 602 does not depend solely on whether the transactions at issue are "in interstate commerce." Pennzoil has advanced two other, equally important, arguments demonstrating that West Virginia has exceeded its powers under Section 602 of the NGPA and the Constitution. *See* Petition for Certiorari at 23-27. Each of those additional arguments is completely independent of any determination of whether the transactions at issue are "in interstate commerce."

Second, contrary to the Memorandum, the question of whether the transactions at issue are "in interstate commerce" is *not* a "fact-bound" issue. No dispute whatsoever exists regarding the facts of Pennzoil's operations in West Virginia or the facts of the transactions at issue. The only necessary determination relevant to whether the transactions at issue are "in interstate commerce" is a purely legal question, and, in Pennzoil's view, the answer to that question is well-settled by precedent of this Court and of lower courts.[5]

Finally, with regard to the question of state authority under Section 602(a) of the NGPA, the Memorandum argues that "because that issue has not been addressed by any other court it has not been the subject of sufficient judicial attention to warrant review by this Court at the present time." Memorandum at 6. The Memorandum continues with the statement that "it would be prudent for the Court to await further developments in the lower courts before addressing the Section 602(a) issue." *Id.* That argument seriously misconstrues the nature and posture of this case.

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[5] *See* Pennzoil's Petition for Certiorari at 22 n.55 and Reply Brief at 9-10.

The issue regarding the application of Section 602(a) of the NGPA is not merely a question of determining the "right" or "wrong" interpretation of that statutory provision. Rather, the fundamental issue is a constitutional question: whether the NGPA preempts the power of the states to regulate prices for natural gas sales in the manner attempted by West Virginia in this case.[6] Thus, if the Public Service Commission and the West Virginia Supreme Court of Appeals have interpreted Section 602 incorrectly, then their actions violate the Constitution.

Pennzoil submits that this Court should not defer decision in a case such as this, where a constitutional question has been properly raised, simply for the purpose of allowing other state courts time to determine whether they also wish to violate the Constitution. If West Virginia is wrong in its interpretation of Section 602, and has violated the Constitution by ignoring the intent of Congress implemented in the pricing provisions of the NGPA, then this Court should correct that constitutional violation without delay, precisely to *prevent* other states from following West Virginia's example. Nothing, except delay of resolution of the issues, can be accomplished by awaiting "further developments" in lower courts.[7]

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[6] *See* Pennzoil's Petition for Certiorari at 20-21.

[7] It should be noted that Pennzoil seeks rate increases before the Public Service Commission of West Virginia relatively frequently, and, therefore, if the Court decides to "await further developments" before addressing the issues presented by this case, one result may be a series of decisions by the West Virginia Supreme Court of Appeals further affirming the precedent set by the Public Service Commission in this case and considerably increasing the irretrievable losses suffered by Pennzoil as a result of the Commission's unconstitutional actions.

CONCLUSION

Pennzoil respectfully requests this Court to grant a Writ of Certiorari to resolve the questions presented by this case, without regard to whatever action the Court may determine is necessary in response to the petitions for certiorari seeking review of the Fifth Circuit's decision in *Mid-Louisiana.*

Respectfully submitted,

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Dated: September 24, 1982

Opposition

Supreme Court, U.S.
FILED
APR 9 1982
ALEXANDER L. STEVAS
CLERK

No. 81-1672

IN THE

Supreme Court of the United States

October Term, 1981

PENNZOIL COMPANY
Petitioner,
v.
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
Respondent.

On Writ of Certiorari to the Supreme Court
of Appeals for the State of West Virginia

BRIEF OF THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA IN OPPOSITION TO PETITION

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QUESTIONS PRESENTED FOR REVIEW

Whether the Supreme Court of Appeals erred in denying a petition for review of a decision of the Public Service Commission of West Virginia pricing the gas petitioner produces and sells to its intrastate utility customers in West Virginia on a cost basis, because the Commission concluded that no "first sale" of petitioner's gas production within the meaning of Section 2(21) of the Natural Gas Policy Act of 1978, 15 U.S.C. §3301(21) had occurred, and that its responsibility under West Virginia law to fix a cost based price for such gas had been expressly preserved by Section 602 of that Act.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED FOR REVIEW i

TABLE OF AUTHORITIES iii

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE WRIT 8

CONCLUSION 17

TABLE OF AUTHORITIES

Page

Judicial Decisions

Atlantic Greyhound Corp. v. Public Service Commission, 132 W. Va. 650, 54 S.E. 2d 169 (1949) 6

Boggs v. McDonald, No. 81-1252, *cert. denied* March 1, 1982 14

California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965) 12, 13

California v. Zook, 336 U.S. 725 (1949) 12

Deep South Oil Co. v. FPC, 247 F.2d 882 (5th Cir. 1957), *cert. denied*, 355 U.S. 930 (1958) 12

Head v. Board of Examiners, 374 U.S. 424 (1963) 12

McGrady v. Callahan, ____ W. Va. ____ 244 S.E. 2d 793 (1978) 6

Mid-Louisiana Gas Company v. FERC, 664 F.2d 530 (5th Cir. 1981) 7, 9, 10

Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 2

Virginia Electric and Power Co. v. Public Service Commission, ____ W. Va. ____, 242 S.E. 2d 698 (1978) 6

Page

Administrative Orders

Final Rule Governing the Maximum Lawful Price for Pipeline Distributor or Affiliate Production, Order No. 58, Docket No. RM80-97, issued November 14, 1979, 44 Fed. Reg. 66577 4

Pennzoil Company, Docket No. G-7004, order issued November 4, 1980 13

Statutes

Natural Gas Act, 15, U.S.C. §§717a, *et seq.* 10

Natural Gas Policy Act of 1978, 15 U.S.C. §3301 *et seq.*
  Section 2(17), 15 U.S.C. §3301(17) 2
  Section 2(21), 15 U.S.C. §3301(21) 3, 9
  Section 105, 15, U.S.C. §3315 4
  Section 601(b) and (c), 15 U.S.C. §3431(b) and (c)
  Section 602(a), 15 U.S.C. §3432(a) 3, 6, 7, 11, 14, 15

W. Va. Code:
  §24-1-1a(4) 2, 5
  §24.2.1 .... 2, 14
  §24-5-1 6,7

Miscellaneous

S. Rep. No. 95-1126, 95th Cong., 2nd Sess. (1978) 15

No. 81-1672

IN THE

Supreme Court of the United States

October Term, 1981

PENNZOIL COMPANY,
Petitioner,

v.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

On Writ of Certiorari to the Supreme Court
of Appeals for the State of West Virginia

BRIEF OF THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA IN OPPOSITION TO PETITION

The respondent, the Public Service Commission of West Virginia, herewith opposes the petition for a writ of certiorari to the Supreme Court of Appeals of West Virginia filed by the petitioner, Pennzoil Company.[1]

STATEMENT OF THE CASE

In 1980 the petitioner, Pennzoil Company (Pennzoil), through its Utility Division, sold 764,300 thousand cubic feet (Mcf) of gas at retail to approximately 5,230 residential and 229 commercial users in West Virginia.

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[1] Pursuant to Rules 22 and 34.2, respondent adopts the portions of the Petition filed in response to Rule 21.1(b), (d), (e) and (f).

As such, Pennzoil is a "local distribution company" within the definition of that term in Section 2(17) of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §3301(17), and a "public utility" supplying gas to West Virginia consumers at retail subject to the regulatory authority of the Public Service Commission of West Virginia (Commission) pursuant to Section 24-2-1 of the Public Service Commission Law of West Virginia, West Virginia Code, §24-2-1.

Of the gas sold by Pennzoil at retail in West Virginia, 60% is produced by Pennzoil within the state, and the remaining 40% is purchased from other producers. The cost of the gas purchased by Pennzoil has been priced to its retail customers at the purchase price. The gas produced by Pennzoil itself has been priced on a cost basis, pursuant to the provisions of Section 24-1-1a(4) of the Public Service Commission Law, West Virginia Code, §24-1-1a(4), providing that the rates and charges for utility services shall be "based primarily upon the costs of providing these services". In recent Pennzoil proceedings the Commission, due to insufficient data as to the actual costs of Pennzoil's gas production,[2] used as an appropriate cost basis the average costs of various West Virginia small producers who sell to interstate pipelines, as determined in a settlement of proceedings before the Federal Energy Regulatory Commission (FERC). Since this price (known as the "IOGA rate") was "the only number reasonably related to the cost of producing gas in the Appalachian area", the West Virginia Commission determined it was appropriate to be used as a surrogate for Pennzoil's own production costs (Pet. App. 13b, 23b-24b).[3]

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[2] Pennzoil produces casinghead gas in West Virginia, i.e., gas produced in conjunction with the production of oil wells. It is difficult to isolate the costs associated with oil production and those with gas production in this situation. *Cf.* Permian Basin Area Rate Cases, 390 U.S. 747, 803-804 (1968).

On November 9, 1978 Congress enacted the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§3301 *et seq.* This Act provides in Title I for a series of "maximum lawful ceiling rates" for various categories of "first sales" of natural gas in both interstate and intrastate commerce. "First sale" is defined in Section 2(21), 15 U.S.C. §3301(21), as any sale *to* an interstate or intrastate pipeline, local distribution company or end user of gas but not including any sale *by* an interstate or intrastate pipeline, local distribution company or affiliate thereof "unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof." Section 602(a) of the Act, 15 U.S.C. §3432(a), provides that:

> Nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable lawful price, if any, under Title I of this Act.

On May 1, 1980 Pennzoil filed a new tariff with the Commission proposing to increase its rate and charges to its retail customers in West Virginia by approximately $1,979,704 per annum. (Pet. App. 1f.) Included in Pennzoil's justification for this filing was a claim that the unit price for the gas to be reflected in its rates was $3.31 per Mcf for its own production and $1.65 per Mcf for the purchases from unaffiliated producers in West Virginia. The $3.31 price for Pennzoil's own production was asserted to be the "weighted average rate calculated under the appropriate provisions of the NGPA" which Pennzoil, as a producer, was entitled to collect for gas sold in interstate commerce (Pet. App. 14f). Pennzoil also submitted to the Commission staff a study purporting to show that the cost of its West Virginia production was $4.69 per Mcf.

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[3] References to the Appendix to the Petition for a Writ of Certiorari in this case are cited as (Pet. App. ____).

The rate application was set for hearing and on February 17, 1981, the Commission's hearing examiner issued his decision (Pet. App. F). He rejected Pennzoil's claim that it was entitled to charge its retail customers the NGPA ceiling rates it was charging interstate pipelines, and also refused to adopt the cost based rate reflected in Pennzoil's study since neither Pennzoil nor the PSC staff had supported the study by competent testimony. Instead, following the Commission's prior decisions as to Pennzoil, he adopted the IOGA rate for the Pennzoil produced gas, which he found to be $1.3945 per Mcf.

In rejecting the $3.31 price the hearing examiner noted that the FERC in its Order No. 58[4] had concluded that production by interstate pipelines would not qualify as "first sales" entitled to NGPA ceiling rates unless the volumes sold were produced exclusively by the pipeline from identifiable wells (Pet. App. 17f-18f). He also noted that Section 105 of the NGPA, 15 U.S.C. §3315, provided that the maximum lawful price for sales under existing intrastate contracts was to be the lower of the contract price or the Section 102 price and that Pennzoil's contract price appeared to be the IOGA price (Pet. App. 18f-20f). Such arguments, he held, (Pet. App. 21f), were "academic" since under Section 602 of the NGPA, West Virginia was free to set rates for in-state production lower than the NGPA prices, and the West Virginia legislature in Section 24-1-1a(4) of the West Virginia Code had expressly directed the Commission to ensure that the rates and charges for public utilities subject to its control were "based primarily on the costs of providing these services."

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[4] "Final Rule Governing the Maximum Lawful Price for Pipeline Distributor or Affiliate Production," Docket No. RM80-97, issued November 14, 1979, 44 F.R. 66577.

The Commission's "Order Modifying Hearing Examiner's Decision" (Pet. App. B), agreed with the Hearing Examiner's conclusion that "Pennzoil is a local distribution company with regard to its West Virginia customers...[and] as such the commingling of its own produced gas with the gas that it purchases from others disqualifies the Company from claiming first sale treatment for the sales it makes from its general system supply" (Pet. App. 21b). Rejecting Pennzoil's suggestion that the intracorporate transaction by which its West Virginia production was transferred to the Utility Division without contract or bargaining could be characterized as a first sale (Pet. App. 22b), the Commission held that the Hearing Examiner's discussion of the first sale issue was "sufficient legal ground" to reject Pennzoil's claim for a NGPA based price of $3.31 per Mcf for its own production (id.). The Commission also expressly found, however, that its authority over Pennzoil's rates and charges to its West Virginia retail customers had not been preempted by the NGPA (Pet. App. 25b) and that it had jurisdiction under Sections 24-1-1, 24-1-2, 24-2-1, 24-2-4 and 24-2-7 of the West Virginia Code to "fix just and reasonable rates primarily based on the cost that Pennzoil incurs in providing gas service to its retail customers in West Virginia" (id.). Finally, the Commission found that the "IOGA Rate" utilized by the Hearing Examiner as the best approximation of Pennzoil's costs should be adjusted upwards to reflect the impact of inflation (Pet. App. 24b).

Pennzoil, without filing a petition for rehearing of the Commission's order as authorized by Rule 19(c) of the Commission's Rules of Practice and Procedure, petitioned the West Virginia Supreme Court of Appeals pursuant to Section 24-5-1 of the Public Service Commission Law, West Virginia Code, §24-5-1, for suspension and review of the Commission's order. While the primary thrust of Pennzoil's petition was that the Commission's order was arbitrary and capricious and not based on substantial evidence of record, it contended, *inter alia,* that it was entitled to the NGPA ceiling rate for its production.

The Commission in its Statement of Reasons for the Entry of Order, filed in accordance with Section 24-5-1 of the Public Service Commission Law, West Virginia Code §24-5-1, stated that Pennzoil's claim to charge NGPA ceiling rates was improper both because no "first sale" was involved and because Section 602 of the NGPA preserved the right of the Commission to establish rates for public utilities based primarily upon their cost of service. The Commission also contended that under *Virginia Electric and Power Company* v. *Public Service Commission,* ___ W. Va. ___ , 242 S.E. 2d 698 (1978), the Commission could employ any methods for determining utility rates it deemed suitable as long as the end result provides good service at fair rates to West Virginia consumers and the utility is able to earn a competitive return upon its West Virginia investment, and that Pennzoil had failed to make any such showing that the rates set by the Commission failed to do this. Finally, the Commission contended that Pennzoil had failed to exhaust its administrative remedies by failing to apply for rehearing of the Commission order, citing *McGrady* v. *Callahan,* ___ W. Va. ___ , 244 S.E. 2d 793 (1978) and *Atlantic Greyhound Corporation* v. *Public Service Commission,* 132 W. Va. 650, 54 S.E. 2d 169 (1949).

After consideration of the pleadings and oral argument, the West Virginia Supreme Court of Appeals on December 10, 1981 issued an order (Pet. App. 1a) denying, without further explanation, the Pennzoil petition for an appeal from, and suspension and review of the Commission's final order.

On January 11, 1982, Pennzoil filed in the West Virginia Supreme Court of Appeals a "Motion for Suspension of Time to Renew Petition for Appeal." This motion noted that on December 23, 1981 the Fifth Circuit Court of Appeals had issued its opinion in *Mid-Louisiana Gas Company* v. *FERC*, 664 F.2d 530 (1981), vacating FERC Order No. 58 which the West Virginia Commission had cited in finding that no NGPA "first sale" was involved in Pennzoil's sales to its retail customers. Since, Pennzoil contended, the Section 602 issue was the only other basis upon which the Commission's order could have been justified and the court's December 11, 1982 order had not made clear whether it had relied on the Commission's "first sale" determination or Section 602 of the NGPA, Pennzoil requested permission to renew its petition for appeal. Pennzoil recognized that its motion was out of time under Rule 7(a) of the court and Section 24-5-1 of the West Virginia Code, but contended that "good cause" existed for waiver of the time limitation pursuant to court Rule 2. No reason was given for filing the motion more than 30 days after the entry of the court's December 10, 1981 order denying the original petition for appeal.

On January 14, 1982, the Commission filed a response in opposition to Pennzoil's motion. The Commission contended that the motion was out of time and Pennzoil had not established good cause for the delay. On the merits, the Commission argued that there was considerable doubt as to whether the Fifth Circuit's decision with respect to first sales by interstate pipelines was applicable to the situation involved in Pennzoil's sales of its production to retail customers in the state, but that, in any event, three additional bases for rejecting Pennzoil's appeal had been raised in the Commission's Statement of Reasons for its order: the reservation of state jurisdiction over in-state production by Section 602 of the NGPA; the failure of Pennzoil to exhaust its administrative remedies; and its failure to show that the Commission's overall rate determination was improper under the court's standards for review.

The West Virginia Supreme Court of Appeals on January 19, 1982 issued an order (Pet. App. 1c) denying the Pennzoil motion to suspend the time requirement to permit it to renew its petition for appeal. The instant Petition for a Writ of Certiorari was filed on March 10, 1982 and served on the Commission on the following day.

REASONS FOR DENYING THE WRIT

The petition in this case contends that the orders of the West Virginia Supreme Court of Appeals, rejecting Pennzoil's appeal from the Commission order pricing the gas it produces in West Virginia for sale at retail within the state on a cost basis, raises substantial questions as to the interpretation of the term "first sale" in the Natural Gas Policy Act of 1978 (NGPA) and the scope of Section 602 of the Act preserving state authority to prescribe lower maximum rates for production in the state. The Court orders (Pet. App. 1a, 1c) do not state the basis for the rejection of Pennzoil's claims and, as indicated, *supra*, the Commission had contended before the court that there were independent state grounds for denying review of its order. Even assuming, however, that the court action was based upon its agreement with one or both of the Commission's constructions of the NGPA, the issues raised by the petition do not, for the reasons set out below, warrant plenary review by this Court. The petition, accordingly, should be denied.

1. Petitioner's primary contention with respect to whether there was a "first sale" of its West Virginia production sold to retail customers in the state, within the meaning of Section 2(21) of the NGPA, 15 U.S.C. §3301(21), is that the Commission's determination that there was no "first sale" conflicts with the opinion of the United States Court of Appeals for the Fifth Circuit in *Mid-Louisiana Gas Company v. FERC*, 664 F.2d 530 (1981). A question exists, which the court below found unnecessary to resolve, as to whether the legal and factual questions involved in intracorporate transfers by interstate pipelines, on the one hand, and local distribution companies, on the other, need lead to similar results in interpreting the meaning of the term "first sales" under the Act. However, even if the court below had expressly adopted a position on the "first sale" question in conflict with the court of appeal's *Mid-Louisiana* opinion, this fact would not justify grant of the writ in this case.

Contrary to petitioner's claim, the possibility that some states would require intrastate pipelines or local distribution companies to accept a lower cost-based price for their production sold at retail within the state than that which would be available to interstate pipelines under the *Mid-Louisiana* decision, does not present a problem of national significance which the

NGPA sought to eliminate.[5] The "dual market" problem which Congress sought to cure in the NGPA arose from the fact that producers selling gas in interstate commerce under the Natural Gas Act, 15 U.S.C. §§717a, *et seq.*, were subject to price regulation by the FERC (and its predecessor, the Federal Power Commission) while intrastate sales by such producers, which were outside the Natural Gas Act, were not regulated at *either* the federal or state level. This dichotomy was eliminated in the NGPA by making the maximum price ceilings for various categories of first sale applicable to intrastate as well as interstate sales. There was no suggestion, however, throughout the lengthy history of the NGPA that Congress perceived a problem as a result of the existing situation under which West Virginia, in common with a number of other states, imposed no regulation upon the price at which producers in the states sold their gas to the interstate market, while fixing the price of gas produced in the state by intrastate pipelines and distributors which was then sold to a retail in the state. On the contrary, the Congress in Section 602 of the NGPA expressly authorized states to prescribe lower rates for gas produced within their borders. Nor can Pennzoil show that the continued cost based pricing of its West Virginia production sold to West Virginia retail customers affects the supply or price of gas to any person other than those customers. To the extent Pennzoil believes that its inability to secure a higher price for its production sold at retail to its West Virginia customers adversely affects its ability to provide them with adequate service, it is free to seek relief from the Commission. This is not, however, a matter of concern to this Court.

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[5] The Commission believes that the *Mid-Louisiana* decision was incorrect in determining that interstate pipelines are entitled to charge their customers NGPA ceiling rates for their own gas production which becomes part of system supply. Since its acceptance as governing the price interstate pipelines could charge for their own production would seriously impact the large number of West Virginia gas consumers dependent for their gas upon pipelines with substantial production operations, the Commission expects to support the petitions for writs of certiorari which we understand will be filed to review that decision.

2. Section 602(a) of the NGPA provides that "[N]othing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under Title I of this Act". Petitioner advances three grounds why it believes that Section 602 does not authorize the Commission to fix the price for Pennzoil's West Virginia production sold to West Virginia customers on the cost basis mandated by West Virginia Law: that the "first sale" of gas was not in intrastate commerce; that West Virginia could only exercise its authority under Section 602 through action by the legislature rather than by the Commission; and, that action under Section 602 can only be by general rule rather than in an order in a specific case. There is no merit to any of these arguments and none of them raise issues of general importance which warrant review by this Court.[6]

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[6] While we believe Section 602 constitutes an express Congressional recognition of the continuing authority of West Virginia to regulate Pennzoil's retail rates on a cost basis, as long as the resultant price is lower than the maximum ceiling prices, Petitioner's assumption that, unless Section 602 is applicable, the Commission's authority over Pennzoil's rates was preempted by the NGPA, is not correct. Even if the intracorporate transfer of the gas could properly be characterized as a "first sale," the NGPA does not purport to prescribe how such sales would be treated in determining the costs of Pennzoil's Utility Division in fixing its rates

There is considerable doubt as to whether Section 602, which preserves state authority to establish or enforce prices below the NGPA ceiling rates for any "first sale of natural gas produced within the state," is limited to sales in intrastate commerce. The Court does not have to reach this question, however, since petitioner's argument, that its intracorporate transfer which arguably constitutes a "first sale" was in interstate commerce because the gas sold to Pennzoil's West Virginia retail customers was commingled in its gathering lines with gas sold to interstate pipelines, is without merit. This Court's decision in *California v. Lo-Vaca Gathering Co.*, 379 U.S. 366 (1965), and the other cases cited by petitioner (Pet. 25, n. 55)[7] do not establish

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to West Virginia retail customers. Specifically, there is nothing in the NGPA applicable to state regulation of local distribution companies equivalent to Section 601(b) and (c) of the Act under which the FERC is required to permit interstate pipelines to pass through first sale acquisition costs to their customers in the absence of fraud, abuse or similar grounds. *See California* v. *Zook*, 336 U.S. 725 (1949); *Head* v. *Board of Examiners*, 374 U.S. 424 (1963). (Preemption of state authority is not to be presumed in the absence of a clear indication of Congressional intent.)

[7] *Deep South Oil Co.* v. *FPC*, F.2d 882 (5th Cir. 1957) *cert. denied* 355 U.S. 930 (1958), which Pennzoil characterizes as "particularly relevant" (Pet. 25., n. 55), is of no help to petitioner. There the court held that a sale of gas by a producer within the state to a company which processed the gas to remove the heavier hydrocarbons and then resold it to an interstate pipeline, was in interstate commerce. The Court looked to the continuous flow of the gas in determining that the initial sale was in interstate commerce: "The fact that the sales are made at the wellhead is immaterial for the particular point at which the title and custody of the gas pass to the purchaser, without arresting its movement to the ultimate interstate destination, does not affect the essential interstate nature of the business". 247 F.2d at 887 (citation omitted). Here, of course, none of the gas at issue leaves the state of production.

that a "sale" of gas produced, transported and sold to retail customers in a single state is in interstate commerce because the gas involved in the sale is commingled with gas sold in interstate commerce in the seller's gathering lines. The issue in *Lo Vaca, supra,* was whether a sale by a producer to an interstate pipeline could avoid regulation under the Natural Gas Act because of a contractual provision specifying, contrary to the actual flows of the gas, that it was to be utilized solely within the state. Here, all of the gas which is the subject of the alleged "first sale" remains in West Virginia. Moreover, in concluding that no artificial contractual restriction could be permitted to create an "attractive gap" in the regulatory scheme, this Court made clear that it was not holding that all situations of commingling would result in a jurisdictional transaction, 379 U.S. at 369-370.

Nor does the order of the FERC in *Pennzoil Co.,* Docket No. G-7004, issued November 24, 1980 (Pet. App. H) permitting Pennzoil to abandon certain interstate service, hold or suggest that any sale of Pennzoil's West Virginia production to West Virginia consumers is or ever was in interstate commerce. As the FERC order makes clear, the 1930 contract which otherwise dedicated all of Pennzoil's West Virginia production to an interstate pipeline, expressly "permitted" sales to Pennzoil's "domestic" retail customers in West Virginia (Pet. App. 3h). The FERC order cited by Pennzoil merely ratified this fact and retroactively approved Pennzoil's abandonment of some of its service to its original interstate customer in order to serve new customers. Nothing in the FERC order suggests that Pennzoil's sales to its retail customers in West Virginia involve an interstate sale over which the FERC has any jurisdiction or regulatory supervision.[8]

Pennzoil argues next that Section 602 authorizes action only by states operating through their legislatures, so that the West Virginia legislature's failure to establish rates at levels below the NGPA ceiling prices since the NGPA became effective means the West Virginia Commission had no authority to do so here. Nothing in the NGPA or its legislative history purports to specify how the state power reserved in Section 602 is to be exercised, or that state agencies, with existing delegated state power may not continue to exercise their authority without additional action by the legislature. Pennzoil's suggestion that the Commission does not possess the power under West Virginia law it expressly asserted over Pennzoil's sales of West Virginia production to retail customers in the state, (Pet. App. 25(b)-26(b)), in addition to being raised for the first time in Pennzoil's petition, not only involves a construction of state law which this Court, under its established standards for review, will not entertain,[9] but flies in the face of state regulation of Pennzoil's retail gas rates for almost half a century.

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[8] See *Boggs v. McDonald, et al.*, No. 81-1252, petition for certiorari denied March 1, 1982, 50 U.S. L.W. 3695, where the FERC filed a memorandum (attached as an appendix to the West Virginia Commission's brief in opposition to the petition for a writ of certiorari in Case No. 81-1252) in the District Court for the Southern District of West Virginia in opposition to a contention that the West Virginia Commission could not direct Boggs to make sales to local retail consumers where he was selling gas to an interstate pipeline, stating that there was no necessary conflict "between Boggs' status as a small producer regulated by FERC and a utility regulated by the PSC."

[9] On its merits, Pennzoil's argument is that the Commission has no jurisdiction to fix the rates of producers. It ignores the fact that Pennzoil is a "public utility" within the meaning of Section 24-2-1 of the West Virginia Public Service Commission Law with respect to the gas service it provides to retail consumers in the state, and as such its rates have always been subject to the regulatory authority of the Commission.

Finally, petitioner contends that the Commission in supplying retail gas service to West Virginia residential and commercial users, could only exercise any authority it might possess under Section 602 by general rule rather than in a specific proceeding involving the rates of a particular local distributor. Since nothing in the language or legislative history of the Section indicates an intent by the Congress to dictate how the states or their agencies should exercise the preserved authority, Pennzoil is limited to surmising that Congress must have intended this in view of Congressional familiarity with regulation of interstate producer rates on an area or nationwide basis and with certain state laws prescribing ceiling prices for production therein. Congress was equally aware, however, that the rates for interstate and intrastate pipelines and local distribution companies are normally fixed on a "case-by-case" basis. Moreover, the language of Section 602(a) also preserves the right of the states to "enforce" lower lawful prices they have established, and the statement in the Conference Report on the NGPA that the state's reserved power "extends to the operation of an indefinite escalator clause"[10] shows that Congress, in adopting Section 602, was concerned with actions peculiarly lending themselves to case-by-case action. In short, there is no basis for petitioner's claim that Congress limited the state action reserved by Section 602 to action of general applicability.

Even if petitioner's substantive arguments with respect to Section 602 were far more convincing, its attempt to demonstrate that affirmance of the

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[10] S. Rep. No. 95-1126, 95th Cong., 2nd Sess. p. 125.

Commission's order in this case would have consequences seriously affecting the national scheme for the regulation of natural gas is totally unpersuasive. There is no basis to petitioner's suggestion that the Commission's action in setting the rates at which Pennzoil can price its West Virginia gas production sold at retail to West Virginia customers, as it has always done, will lead to the wholesale regulation by state of the rates at which producers in the state can sell gas to interstate pipelines, as no state has ever attempted. No problems of general significance have been created by the Commission's exercise of its authority to fix Pennzoil's rates for a gas sold at retail in West Virginia in the past and there is no reason to assume that reaffirmance of the state's authority to fix lower rates for gas produced within its borders will do so in the future. Significantly, West Virginia has not made any effort to reduce the maximum lawful rates at which Pennzoil or any other producer within the state may sell gas in interstate commerce or to any unaffiliated intrastate pipeline or local distribution company.

CONCLUSION

The petition raises no question warranting plenary review by this Court of the Supreme Court of Appeals' orders denying review of the Commission's action pricing Pennzoil's West Virginia production sold at retail to West Virginia customers on a cost basis. The petition should be denied.

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April 9, 1982

Petitioner's
Reply Brief

Office - Supreme Court, U.S.
FILED
APR 28 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-1672

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

PENNZOIL COMPANY,
Petitioner,
v.
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA,
Respondent.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS FOR THE STATE OF WEST VIRGINIA

REPLY BRIEF OF PENNZOIL COMPANY TO BRIEF IN OPPOSITION TO PETITION

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TABLE OF CONTENTS

Page

I. ARGUMENT 1

A. No Adequate And Independent State Grounds Existed. 2

B. The Supreme Court Of Appeals Rejected Pennzoil's Timely Request That It Resolve The Conflict With The Fifth Circuit 4

C. The Commission's Discussion Of The Merits Demonstrates The Importance Of The Questions Presented For Review 6

II. CONCLUSION 10

APPENDIX A: Public Service Commission of West Virginia Rule 19

APPENDIX B: West Virginia Code § 24-5-1

APPENDIX C: Motion for Suspension of Time to Renew Petition for Appeal

APPENDIX D: Rule 24 of the Supreme Court of Appeals of West Virginia

APPENDIX E: Rule 16 of the Supreme Court of Appeals of West Virginia

APPENDIX F: Rule 7 of the Supreme Court of Appeals of West Virginia

TABLE OF CITATIONS

Cases

Page

Atlantic Greyhound Corp. v. *Public Service Commission*, 132 W. Va. 650, 54 S.E.2d 169 (W. Va. 1949) 3

McGrady v. *Callahan*, —— W. Va. ——, 244 S.E.2d 793 (W. Va. 1978) 3

Mid-Louisiana Gas Co. v. *FERC*, 664 F.2d 530 (1981) *reh'g denied*, —— F.2d —— (5th Cir. 1982), *petition for cert. filed*, —— U.S.L.W. —— (U.S. April 12, 1982, No. 81-1889) .... *passim*

Missouri v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924) 9

Perez v. *Campbell*, 402 U.S. 637 (1971) 4

Public Service Commission v. *FERC*, 610 F.2d 439 (6th Cir. 1979) 10

State Corporation Commission v. *Wichita Gas Co.*, 290 U.S. 561 (1934) 9

Testa v. *Katt*, 330 U.S. 386 (1947) 4

Virginia Electric & Power Company v. *Public Service Commission*, —— W.Va. ——, 242 S.E.2d 698 (W.Va. 1978) 3, 4

STATUTES

Natural Gas Policy Act of 1978,
Section 2(21), 15 U.S.C. § 3301(21) 1, 7
Section 602(a), 15 U.S.C. § 3432 1

West Virginia Code
§ 24-5-1 3

RULES AND REGULATIONS

Rules of Practice and Procedure of the Public Service Commission of West Virginia
Rule 19(a) 2
Rule 19(c) 2

Rules of the Supreme Court of Appeals of West Virginia
Rule 7 5
Rule 16(a) 5
Rule 24 5

No. 81-1672

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PENNZOIL COMPANY,
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ON WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS FOR THE STATE OF WEST VIRGINIA

REPLY BRIEF OF PENNZOIL COMPANY TO BRIEF IN OPPOSITION TO PETITION

On March 10, 1982, Pennzoil Company (Pennzoil) filed its Petition for a Writ of Certiorari in this case. On April 9, 1982, the Public Service Commission of West Virginia (Commission) filed its Brief in Opposition to Pennzoil's Petition. For the most part, the Commission's Brief in Opposition argues the merits of the questions presented for review, rather than stating reasons why this Court should deny Pennzoil's Petition. In Pennzoil's view, the Commission's Brief only helps to demonstrate that the questions presented in this case are substantial and warrant review on certiorari. In this Reply Brief, Pennzoil responds to the issues of fact and law raised for the first time in the Commission's Brief in Opposition.

I. ARGUMENT

The Commission's Brief fails to refute the reasons set forth in Pennzoil's Petition for granting a writ of certiorari. First, contrary to the Commission's assertion, no adequate and independent state grounds could have existed for the decision of the West Virginia Supreme Court of Appeals. Second, despite the fact that Pennzoil informed the Supreme Court of Appeals in a timely manner of the direct conflict between its decision and the opinion of the Fifth Circuit in *Mid-Louisiana*, the Supreme Court of Appeals refused to reconsider its decision. Finally, the Commission's discussion of the merits discloses several new and substantial federal questions, which emphasize the need for a writ of certiorari in this case.

A. No Adequate And Independent State Grounds Existed.

The Commission argues, almost in passing, that the Supreme Court of Appeals may have relied on independent state grounds in denying review of the Commission's order.[1] The Commission never actually asserts, however, that either of the possible state grounds it cites could have been adequate. Indeed, such an assertion would be incorrect, as both of the alleged state grounds are entirely spurious.

The Commission first asserts that the Supreme Court of Appeals may have denied review because Pennzoil did not file a petition for rehearing of the Commission's Order with the Commission itself before seeking judicial relief. The Commission's Brief notes that such a petition for rehearing is "authorized" by Rule 19(c) of the Commission's Rules of Practice and Procedure.[2] However, the Brief fails to point out that nothing in the Commission's Rules *requires* the filing of a petition for rehearing before the Commission as a jurisdictional prerequisite for seeking judicial review of a Commission order. The Commission's Rules authorize, but do not require, the filing of a petition for rehearing of any "final order" within ten days after the order is mailed.[3] Similarly, nothing in the statutory requirements for review of Commission orders requires the filing of a petition for rehearing before the Commission as a jurisdictional prerequisite to judicial review. The statute permits an aggrieved party to file a petition for review within thirty days after entry by the Commission of a "final order."[4] The use of the term "final order" in both the Commission's Rules and the statute governing judicial review demonstrates that, once the Commission issues a "final order," an aggrieved party has the *option* of filing a petition for rehearing before the Commission or immediately seeking judicial review.[5] Pennzoil chose not to file a petition for rehearing with the Commission in this case because the Commission's position was unequivocal and the only issue for decision was the legal issue of the applicability of the NGPA.

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[1] Brief of the Public Service Commission of West Virginia in Opposition to Petition at 6, 8 [hereinafter cited as "Commission Brief"].

[2] Commission Brief at 6.

[3] Rule 19(a). The relevant portion of Rule 19 is set forth in Appendix A to this Reply Brief [hereinafter, the appendices to this Reply will be referred to as "App. ——"].

The Commission also asserts that the Supreme Court of Appeals might have relied on a previous decision, *Virginia Electric & Power Co.* v. *Public Service Commission*, —— W. Va. ——, 242 S.E.2d 698 (W. Va. 1978), as a basis for denying Pennzoil's appeal. Paraphrasing the language of an unofficial headnote to *Virginia Electric*, the Brief argues that "the Commission could employ any methods for determining utility rates it deemed suitable as long as the end result provides good service at fair rates to West Virginia consumers and the utility is able to earn a competitive return upon its West Virginia investment."[6]

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[4] W. Va. Code § 24-5-1. The text of § 24-5-1 is set forth in App. B.

[5] The two cases cited in the Commission's Brief, McGrady v. Callahan, —— W. Va. ——, 244 S.E.2d 793 (W. Va. 1978) and Atlantic Greyhound Corp. v. Public Service Comm'n, 132 W. Va. 650, 54 S.E.2d 169 (W. Va. 1949) do not provide any support for the Commission's argument. The decision in *McGrady* did not involve any interpretation of the Public Service Commission statute or regulations. The decision in *Atlantic Greyhound Corp.* merely states that the Commission has the power to rehear its decisions, if it so desires. Neither case states, or even remotely implies, that the filing of a petition for rehearing before the Commission is a jurisdictional prerequisite to judicial review.

[6] Commission Brief at 6.

The language of the headnote to *Virginia Electric*, on which the Commission now relies, does not reflect one overriding principle: the Commission is bound to apply and enforce governing federal statutes. It is fundamental that "the Constitution and the laws passed pursuant to it are the supreme laws of the land, binding alike upon states, courts, and the people, 'any-thing in the Constitution or Laws of any State to the contrary notwithstanding.' "[7]

In the proceeding below, Pennzoil alleged that the Commission's Order violated the requirements of the NGPA and that the Commission had exceeded its powers under that statute. Thus, the Supreme Court of Appeals was not free to disregard Pennzoil's arguments and rely only on an examination of the end result under *Virginia Electric*. The obligation of the Supreme Court of Appeals to apply and enforce federal law overrides any state law concept of deference to the ratemaking decisions of the West Virginia Commission. Since the applicability of the NGPA was the only issue before the court, the court's decision to deny Pennzoil's appeal must have been based on a conclusion that the Commission's actions did not violate the NGPA.

B. The Supreme Court Of Appeals Rejected Pennzoil's Timely Request That It Resolve The Conflict With The Fifth Circuit.

On January 11, 1982, Pennzoil filed with the Supreme Court of Appeals a "Motion for Suspension of Time to Renew Petition for Appeal."[8] In that Motion, Pennzoil informed the Supreme Court of Appeals of the relevance to the court's decision of the Fifth Circuit's opinion in *Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530 (5th Cir. 1981), and requested an opportunity to brief the court fully on the implications of the Fifth Circuit's decision.[9] Because

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[7] Testa v. Katt, 330 U.S. 386, 391 (1947), quoting U.S. Const. art. VI, § 2; *cf.* Perez v. Campbell, 402 U.S. 637, 644-52 (1971).

[8] The full text of Pennzoil's Motion is set forth at App. C.

[9] Before filing its Motion, counsel for Pennzoil consulted with the

Pennzoil desired to afford the Supreme Court of Appeals a timely opportunity to reconsider its decision in light of *Mid-Louisiana*, Pennzoil filed its Motion as the equivalent of a petition for rehearing, within the period prescribed by the court's Rules for seeking rehearing of the court's decision.[10]

The Commission's Brief now asserts that "no reason was given for [Pennzoil's] filing the motion more than thirty days after the entry of the court's December 10, 1981 order denying the original petition for appeal."[11] Review of a standard calendar reveals, however, that the thirtieth day following the entry of the court's December 10, 1981 decision fell on Saturday, January 9, 1982. Under the court's Rules regarding computation of time, the thirty day period for filing a petition for rehearing could not expire on a Saturday, Sunday or holiday and, therefore, the thirty day period was automatically extended until the next working day, Monday, January 11, 1982.[12] Thus, Pennzoil's Motion was filed within the time required for filing a petition for rehearing.[13]

By filing its Motion, Pennzoil provided the court with an opportunity to modify its December 10, 1981 decision to reconcile the direct conflict between its decision and the opinion of the Fifth Circuit in *Mid-Louisiana*. The fact that the Supreme Court of Appeals chose not to reconsider its decision indicates that it did not view *Mid-Louisiana* as a

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Clerk of the Supreme Court of Appeals. The Clerk informed counsel for Pennzoil that a petition for rehearing would not lie in this case, under Rule 24 of the court's Rules of Appellate Procedure, because the court's opinion did not discuss the basis for the decision. The relevant portion of Rule 24 is set forth in App. D.

[10] *See* Rule 24; App. D.

[11] Commission Brief at 7.

[12] *See* Rule 16(a). The full text of Rule 16(a) is set forth in App. E.

[13] Pennzoil's Motion requested a suspension of the time prescribed by the court's Rules for "renewing" Pennzoil's original appeal of the Commission's Order. *See* Rule 7, set forth in App. F. Under West Virginia rules, this procedure is an alternative to the procedure for seeking rehearing.

controlling authority. Instead of modifying its decision, the court chose to ignore the Fifth Circuit's statement of the law, and the conflict remains for this Court to resolve.

C. The Commission's Discussion Of The Merits Demonstrates The Importance Of The Questions Presented For Review.

The Commission's efforts to argue the merits of questions presented for review demonstrate remarkably well that the questions stated in Pennzoil's Petition are substantial, and that resolution of those questions by this Court is essential. In particular, the Commission's statement that it intends to support petitions seeking certiorari in *Mid-Louisiana*[14] constitutes a tacit admission of the need to grant certiorari also in this case, which provides a concrete test of how, and whether, the interpretation of the NGPA announced in *Mid-Louisiana* will be implemented by the states. In addition, the Commission's Brief reveals several new issues, each of which is substantial and warrants a grant of certiorari in itself.

First, the Commission questions whether a direct conflict exists between the decision of the West Virginia Supreme Court of Appeals and the opinion of the Fifth Circuit in *Mid-Louisiana*. The Commission states:

> A question exists, which the court below found unnecessary to resolve, as to whether the legal and factual questions involved in intracorporate transfers by interstate pipelines, on the one hand, and local distribution companies, on the other, need lead to similar results in interpreting the meaning of the term "first sales" under the Act.[15]

The Commission's assertion is plainly and simply wrong. The Fifth Circuit's opinion in *Mid-Louisiana* announced an authoritative and generally applicable interpretation of the

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[14] Commission Brief at 10 n.5. The Public Service Commission of New York filed the first petition for certiorari in *Mid-Louisiana* in this Court on April 12, 1982, in Docket No. 81-1889.

[15] Commission Brief at 9.

NGPA definition of "first sale." By its express terms, the NGPA definition refers to "volumes of natural gas produced by [an] interstate pipeline, intrastate pipeline, *or local distribution company* or any affiliate thereof."[16] In *Mid-Louisiana,* the Fifth Circuit quoted those exact words and announced an interpretation and holding that are clearly applicable to gas produced by local distribution companies as well as interstate pipelines.[17] The Commission's assertion now, that Congress could have intended one NGPA definition of "first sale" to apply to interstate pipelines, while applying a separate, more restrictive definition to local distribution companies, simply ignores the plain language of the statute and the Fifth Circuit's decision. The Commission's position that some unspecified distinction exists raises a federal question substantial enough in itself to warrant a grant of certiorari in this case.

The Commission further argues for the first time:

> Even if the intracorporate transfer of the gas could properly be characterized as a "first sale," the NGPA does not purport to prescribe how such sales would be treated in determining the costs of Pennzoil's Utility Division in fixing its rates to West Virginia retail customers. Specifically, there is nothing in the NGPA applicable to state regulation of local distribution companies equivalent to Section 601(b) and (c) of the Act under which the FERC is required to permit interstate pipelines to pass through first sale acquisition costs to their customers in the absence of fraud, abuse or similar grounds.[18]

The Commission's assertion that it has the power to prevent Pennzoil from recouping the cost of its produced gas in the rates charged to retail customers is totally devoid of merit. With respect to state regulation of retail sales, the Fifth Circuit stated in *Mid-Louisiana:*

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[16] 15 U.S.C. § 3301(21) (emphasis added).

[17] *See* 664 F.2d at 537-38.

[18] Commission Brief at 11-12 n.6.

> [I]f the NGPA prices attached to the intracorporate transfer by the producer then the state's jurisdiction over retail sales would remain intact. The only change would be that the cost of the gas to the pipeline or distribution company would be the NGPA price. Jurisdiction to set the final retail charge would remain with the state. Although the retail price would reflect the NGPA cost of gas, that change is consistent with Congress' desire to establish a uniform price for producers of both intrastate and interstate gas.[19]

Thus, the Commission's assertion that it has the power to prevent the Utility Division from passing through its cost of Pennzoil's produced gas in its retail sales is directly contrary to the language of *Mid-Louisiana* and the intent of Congress in the NGPA. If the Commission's interpretation were correct, then state commissions would have the power to nullify Section 2(21) of the NGPA and the Fifth Circuit's decision in *Mid-Louisiana*.

Finally, the Commission's Brief contains several important factual and legal errors in its argument regarding Pennzoil's position that the "first sale" of Pennzoil's produced gas takes place in interstate, rather than intrastate, commerce. First, the Commission argues that "there is considerable doubt as to whether Section 602 . . . is limited to sales in intrastate commerce."[20] However, the Commission's argument is expressly contradicted by the explanation of Section 602 set forth in the Conference Report.[21] In addition, any attempt by West Virginia, or any other state, to regulate prices for sales of natural gas in *interstate* commerce is unequivocally precluded by the Constitution of the

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[19] 664 F.2d at 537.

[20] Commission Brief at 12.

[21] The Conference Report states that "nothing in this Act shall affect the authority of any State to establish or enforce any maximum lawful price for sales of gas *in intrastate commerce*. . . ." H.R. Rep. No. 1752, 95th Cong., 2d Sess. 124, *reprinted in* 1978 U.S. Code Cong. & Ad. News 8983, 9041 (emphasis added).

United States.[22] The Commission's assertion that it possesses the authority to regulate prices charged in interstate sales raises a serious constitutional question, worthy of review by this Court.

Next, the Commission's Brief attempts to distinguish this case from decisions of this Court regarding the commingling of gas destined for interstate commerce with gas to be sold in intrastate commerce.[23] The Commission predicates its argument on an unarticulated assumption that any "first sale" could only take place at the point of sale to a West Virginia customer. That assumption conflicts with the express holding of *Mid-Louisiana*, which determined that the "first sale" takes place at the point of transfer from production to transportation.[24] Further, the Commission's argument ignores the possibility that, in this case, the "first sale" could be deemed to occur at the point of transfer from Pennzoil's transportation facilities to the distribution facilities of the Utility Division, when the transfer is formally recognized by Pennzoil and the Utility Division for purposes of accounting between those two entities.

In addition, the Commission's Brief twice incorrectly states that none of Pennzoil's produced gas which is the subject of the "first sale" at issue in this case ever leaves West Virginia.[25] At the point of the "first sale," however, gas destined for sale to interstate pipelines is commingled with gas destined for sale to West Virginia customers. Thus, although it is impossible to determine with absolute certainty, it is highly likely that a substantial portion of Pennzoil's produced gas leaves West Virginia after the "first sale" takes place, and the facts of this case fall squarely within the settled case law regarding the effects of commingling.[26]

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[22] *See, e.g.*, State Corporation Comm'n v. Wichita Gas Co., 290 U.S. 561, 563-64 (1934); Missouri v. Kansas Natural Gas Co., 265 U.S. 298, 307-08 (1924).

[23] Commission Brief at 12 n.7 & 13.

[24] 664 F.2d at 538.

[25] Commission Brief at 12 n.7 & 13.

II. CONCLUSION

Pennzoil submits that the questions presented by this case are substantial, and no adequate and independent state grounds could have existed for the decision of the Supreme Court of Appeals. The Commission's position regarding the applicability of the NGPA is in direct conflict with the holding of the Fifth Circuit in *Mid-Louisiana*. Therefore, Pennzoil respectfully requests this Court to grant a Writ of Certiorari to resolve the questions presented.

Respectfully submitted,

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Dated: April 28, 1982

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[26] *See* cases cited in Petition for Certiorari at 22 n.55. *See also* Public Service Comm'n v. FERC, 610 F.2d 439, 444 (6th Cir. 1979) (Holding that the "ultimate sale in other states of a substantial part of a producer's natural gas output invokes federal jurisdiction over the entire volume of production.")

APPENDIX A

RULES OF PRACTICE AND PROCEDURE OF THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

Rule 19: Further Hearing, Reopening, or Rehearing

(a) Application by Petition

Applications for (1) further hearing in a proceeding after the closing of testimony and before final submission on oral argument or brief, for (2) reopening a proceeding after final submission and before decision, or for (3) rehearing or reargument after decision, must be made by petition, duly verified, within ten (10) days after the date of such closing of testimony, final submission or within ten (10) days after the final order was mailed by the Commission to the parties of record, as the case may be. Such petition shall state specifically the grounds relied upon, and shall be filed with the Commission and a copy served by the petitioner upon each adverse party, or his attorney, who appeared at the hearing, or oral argument, if any, or on brief.

(b) Further Hearing, or Reopening

If the application be for further hearing before final submission, or for reopening the proceeding to take further evidence after submission and before decision, the nature and purpose of the evidence to be adduced must be briefly stated, and it must appear not to be merely cumulative.

(c) Rehearing or Reargument

If the application be for rehearing or reargument after decision, the matters claimed to have been erroneously decided must be specified and the alleged errors stated. If thereby any order of the Commission is sought to be vacated, reversed, or modified, by reason of matters which have arisen since the hearing, or by reason of consequences which would result from compliance therewith, or by reason of facts not in possession of the petitioner at the time of the hearing, the matter so relied upon by the petitioner must be fully set forth in the petition.

. . . .

APPENDIX B

W. Va. Code § 24-5-1. Review of Final Orders of Commission.

Any party feeling aggrieved by the entry of a final order by the commission, affecting him or it, may present a petition in writing to the supreme court of appeals, or to a judge thereof in vacation, within thirty days after the entry of such order, praying for the suspension of such final order. The applicant shall deliver a copy of such petition to the secretary of the commission on or before the date the same is presented to the court or the judge, and it shall be the duty of the secretary promptly to file with the clerk of said court all papers, documents, evidence and other records constituting the complete record in the case, or certified copies thereof, as were before the commission at the time of the entry of the order from which the appeal is taken. The court or judge shall fix a time for the hearing on the application, but such hearing, unless by agreement of the parties, shall not be held sooner than five days after its presentation; and notice of the time and place of such hearing shall be forthwith delivered to the secretary of the commission, so that the commission may be represented at such hearing by one or more of its members or by counsel. If the court or the judge after such hearing be of the opinion that a suspending order should issue, the court or the judge may require bond, upon such conditions and in such penalty, and impose such terms and conditions upon the petitioner, as are just and reasonable. The commission shall file with the court before the day fixed for the final hearing a written statement of its reasons for the entry of such order, and after arguments by counsel the court shall decide the matter in controversy as may seem to be just and right.

APPENDIX C

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA CHARLESTON

PSC Case No. 80-175-G-42T

PENNZOIL COMPANY, a corporation, *Petitioner*,

v.

THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA, *Respondent*.

MOTION FOR SUSPENSION OF TIME TO RENEW PETITION FOR APPEAL

To: The Honorable Justices of the Supreme Court of Appeals of West Virginia:

Comes now Pennzoil Company (Pennzoil), and pursuant to Rules 2 and 7 of the Rules of Appellate Procedure of the West Virginia Supreme Court of Appeals as amended, respectfully moves this Honorable Court to suspend the requirement of Rule 7(a) regarding the time for renewing a petition for appeal to allow Pennzoil to renew its appeal from the order entered September 10, 1981.[1] Good cause for the extraordinary relief of a suspension of Rule 7 to allow Pennzoil to renew its petition exists due to the decision of the United States Court of Appeals for the Fifth Circuit, on December 23, 1981, in *Mid-Louisiana Gas Co. v. Federal Energy Regulatory Commission*, Nos. 80-3804 *et al.* (5th Cir. 1981),[2] which decided the major issue presented in this case in a way directly contrary to the Order of the Public Service Commission reviewed by this Court. The Fifth Circuit's Opinion was issued after this Court entered its December 10, 1981 Judgment and its December 17 and 22 stay orders. Thus, Pennzoil respectfully brings this matter back before the Court for further consideration in light of the Fifth Circuit's decision. In support of its motion, Pennzoil says that:

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[1] For the convenience of the Court, a copy of the Commission's Order is attached as Appendix A. If the official Record of the proceeding already has been returned to the Commission, Pennzoil respectfully requests that the Commission be directed to transmit the Record to the Court for further consideration.

[2] A copy of the Fifth Circuit's Opinion is attached as Appendix B.

(1) The major issue presented in Pennzoil's appeal was whether Pennzoil's own produced gas sold to customers in West Virginia should be priced under the provisions of the Natural Gas Policy Act of 1978 (NGPA).[3] Relying primarily on Order No. 58 of the Federal Energy Regulatory Commission (FERC), the Public Service Commission refused to utilize the applicable NGPA price as the cost of Pennzoil's own produced gas.

(2) The recent decision of the United States Court of Appeals for the Fifth Circuit in *Mid-Louisiana Gas Co. v. Federal Energy Regulatory Commission*, Nos. 80-3804 *et al.* (Dec. 23, 1981) vacates FERC Order No. 58, which was the central basis of the Order of the Public Service Commission.

(3) The aforementioned decision squarely affirms the very theory relied upon by Pennzoil in this case, holding that the intracorporate transfer of natural gas between producing and transportation divisions of a company is a "first sale" under the Natural Gas Policy Act of 1978, as argued by Pennzoil, but contrary to the Order of the Public Service Commission.

(4) Because the Judgment of this Honorable Court entered on December 10, 1981 does not cite the grounds for the denial of Pennzoil's petition for appeal, this Court may have based its rejection on the reasoning of the Public Service Commission regarding FERC Order No. 58,

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[3] 15 U.S.C. §§ 3301-3432.

which has now been held invalid by the Fifth Circuit. Accordingly good cause exists for this Court to reconsider its rejection of the appeal in light of the Fifth Circuit's clarification of the law.

(5) Because the central basis of the Order of the Public Service Commission has now been vacated and found to be contrary to the intent of the Congress of the United States, Pennzoil desires to renew its petition for appeal to afford this Court the opportunity to correct the Commission's erroneous Order.

(6) In view of the Fifth Circuit's decision, the only possible remaining basis for the Order of the Public Service Commission is its interpretation of Section 602 of the Natural Gas Policy Act of 1978 concerning the power of the States to set maximum lawful prices.

(7) Pursuant to Rule 2 of the Rules of this Court, because of the clarification of the law by the Fifth Circuit's December 23, 1981 decision, a suspension of the time requirement imposed by the operation of Rule 7(a) and the provisions of W. Va. Code Section 24-5-1 is warranted to permit Pennzoil to renew its petition for appeal and to allow full briefing of the single remaining issue.

GROUNDS FOR RELIEF

A. The Decision of the Fifth Circuit Invalidates the Central Basis of the Commission's Order.

In the proceeding before the Public Service Commission, the question presented on exceptions to the decision of the Hearing Examiner was the "appropriate price to be set for Pennzoil's produced gas for inclusion in the rates it charges its retail customers in West Virginia." Commission Order at 11. Pennzoil argued that the prices established in the Natural Gas Policy Act of 1978 are applicable to Pennzoil's produced gas sold to consumers in West Virginia,[4] and that the NGPA requires the Commission to use the appropriate NGPA price as the cost of Pennzoil's produced gas in calculating a just and reasonable rate pursuant to Chapter 24 of the West Virginia Code.

The decision of the Public Service Commission rejected Pennzoil's argument on the basis of the Commission's interpretation of the requirements of Order No. 58 of the Federal Energy Regulatory Commission. The Commission's entire discussion and ultimate conclusion denying the applicability of NGPA prices relies on FERC Order No. 58 in support of the proposition that Pennzoil's own produced gas cannot qualify for "first sale" prices under the NGPA because the produced gas is commingled with purchased gas. Commission Order at 12, 13, 14, 15, 17.

The Commission also discussed the holding of the Hearing Examiner and the Exceptions filed by Pennzoil regarding the proper interpretation of Section 602 of the NGPA, which grants the States the power, in certain instances, to establish a maximum lawful price for the first sale of natural gas produced in a state. Commission Order at 3-7. Relying on the reasoning of the Hearing Examiner and rejecting Pennzoil's interpretation of Section 602, the Commission reached the following Conclusion of Law:

> The Commission's authority and duty to establish the appropriate price for Pennzoil to include in its rates and charges for its own produced gas sold to its West Virginia retail customers has not been preempted by the NGPA, the NGA, or the FERC, through its regulations and orders issued pursuant thereto.
> Commission Order at 17.

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[4] No factual issue exists regarding the proper classification of Pennzoil's production under the NGPA, because Pennzoil, the West Virginia Department of Mines, and the FERC have completed the well determination process prescribed by the NGPA with respect to all wells at issue in this case.

In *Mid-Louisiana Gas Co. v. Federal Energy Regulatory Commission*, Nos. 80-3804 *et al.* (5th Cir. 1981), the Fifth Circuit found Order No. 58 to be contrary to the intent of Congress as expressed in the NGPA, and vacated Order No. 58 in its entirety. Slip op. at 13822-26. The court held that, contrary to Order No. 58:

> Congress clearly intended for any production attributable to an "interstate pipeline, intrastate pipeline or local distribution company, or any affiliate thereof" to be accorded first sale status under the NGPA and . . . Congress contemplated that the intracorporate transfer of pipeline production to the pipeline would be treated as the first sale. Slip op. at 13826.

This holding directly contradicts the decision of the Hearing Examiner and the Order of the Public Service Commission insofar as they found NGPA prices inapplicable to Pennzoil's produced gas. Thus, the central basis of the Commission's Order is now invalid.

In view of the Fifth Circuit's decision, only one possible theory for upholding the Commission's Order remains. That theory is the Commission's argument regarding the interpretation of Section 602 of the NGPA.

Since the Fifth Circuit has held that NGPA prices are applicable in the fact situation that exists in this case, the Public Service Commission only may refuse to utilize those prices if the State of West Virginia has acted pursuant to Section 602 of the NGPA to establish its own maximum lawful prices for first sales of natural gas produced in West Virginia. The Public Service Commission contends that it has the authority under Chapter 24 of the West Virginia Code to establish maximum lawful prices for the State of West Virginia under Section 602 of the NGPA. Pennzoil disputes that contention, and argues that only the Legislature of the State of West Virginia, and not the Public Service Commission, may exercise the authority granted under Section 602. In addition, Pennzoil argues that Section 602 only permits the Legislature to set prices applicable to gas solely in intrastate commerce. Pennzoil submits that the provisions of Chapter 24 of the West Virginia Code do not constitute authority for the Public Service Commission to act pursuant to Section 602 of the NGPA. Since the Legislature has neither exercised its authority under Section 602, nor properly delegated that authority to any regulatory body in the State, the Public Service Commission is precluded by the NGPA from utilizing any price other than the applicable NGPA price as the cost of Pennzoil's produced gas.

B. Good Cause Exists to Allow Pennzoil to Renew its Petition.

On December 10, 1981, this Honorable Court denied Pennzoil's Petition for Review of the Order of the Public Service Commission. Because the Court's judgment does not cite the reasons for the denial of the Petition, Pennzoil is unable to determine whether this Court relied primarily on the Commission's holding regarding FERC Order No. 58, or whether this Court also relied in part on the reasoning of the Hearing Examiner, as adopted by the Commission, regarding the powers of the Commission under Section 602 of the NGPA. Pennzoil respectfully suggests that, if this Court's denial was based on the Commission's holding regarding FERC Order No. 58, the Court may wish to reexamine its Judgment in light of the Fifth Circuit's recent decision holding Order No. 58 contrary to the intent of Congress. In addition, Pennzoil respectfully suggests that if this Court also relied in part on the Commission's interpretation of Section 602 of the NGPA, then the Court should allow the filing of supplemental briefs addressing that issue alone, since it now is the only possible basis for the Commission's decision.

For all of the foregoing reasons, in order to provide this Court with an opportunity to reexamine its Judgment, Pennzoil seeks to renew its Petition for Appeal pursuant to Rule 7 of the Rules of this Court. Because Rule 7(a) requires that a petition may only be renewed "during the period prescribed by law," and because W. Va. Code Section 24-5-1 prescribes that a petition for appeal of an order of the Public Service Commission must be filed within thirty days after the entry of the order, Pennzoil respectfully requests that the time requirement of Rule 7(a) be suspended to allow Pennzoil to renew its petition. Pennzoil submits that, pursuant to Rule 2, good cause exists for this Honorable Court to allow Pennzoil to renew its petition for appeal in this case.

Respectfully submitted,

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APPENDIX D

RULES OF THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

Rule 24. Petition for Rehearing.

(a) Time for Filing; Content; Answer; Action by Court if Granted. A petition for rehearing, together with twelve copies thereof, may be filed within thirty days after entry of judgment unless the time is shortened or enlarged by order. The petition shall state with particularity the points of law or fact which in the opinion of the petitioner the court has overlooked or misapprehended and shall contain such argument in support of the petition as the petitioner desires to present. Oral argument in support of the petition will not be permitted unless the court otherwise orders. No answer to a petition for rehearing is required, but if the rehearing petition is granted the other parties shall be notified and may be requested to file further a counter-petition and memorandum of authorities. If a petition for rehearing is granted, the court may make a final disposition of the cause without reargument or may restore it to the calendar for reargument or resubmission or may make such other orders as are deemed appropriate under the circumstances of the particular case.

APPENDIX E

Rule 16. Computation and Extension of Time.

(a) Computation of Time. In computing any period of time prescribed by these rules, by an order of the supreme court, or by any applicable statute, the day of the act, event, or default from which the designated period of time begins to run shall not be included. The last day of the period shall be included, unless it is a Saturday, a Sunday, or a legal holiday. When the period of time prescribed or allowed is less than seven days, intermediate Saturdays, Sundays, and legal holidays shall be excluded in the computation. As used in this rule, "legal holiday" includes New Year's Day, Washington's Birthday, Memorial Day, West Virginia Day, Independence Day, Labor Day, Columbus Day, Veterans Day, Thanksgiving Day, Christmas Day, and any other day appointed as a holiday by the President, Congress of the United States, governor, or legislature of West Virginia.

APPENDIX F

Rule 7. Rejection or Allowance of Appeal.

(a) Rejection. If the petition for appeal is rejected by the supreme court on the ground that the judgment or order is plainly right, no other petition for appeal from that judgment or order shall be permitted. If the petition for appeal is rejected on any other ground, or if no ground be cited in the rejection, the petitioner may renew the petition as many times as he desires during the period prescribed by law for presentation of petitions.

(b) Renewal of Petition. A petitioner desiring to renew a petition may notify the clerk of the supreme court of his intention in writing within thirty days after the entry of the order denying his application. In such case, the clerk shall retain the petition and record in the supreme court, the petition may be reheard in accordance with Rule 5 and, an amended petition or supplemental argument may be filed.

. . . .

Brief for the
United States

No. 81-1672

Office - Supreme Court, U.S.
FILED
JUL 28 1982
ALEXANDER L. STEVAS.

In the Supreme Court of the United States

OCTOBER TERM, 1982

PENNZOIL COMPANY, PETITIONER

v.

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

MEMORANDUM FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

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TABLE OF CONTENTS

Page

Statement 1

Discussion 4

Conclusion 7

TABLE OF AUTHORITIES

Case~~s~~:

Mid-Louisiana Gas Co. v. *FERC*, 664 F. 2d 530, petitions for cert. pending, Nos. 81-1889, 81-1958, 81-2042 and 82-19 .... 3, 4, 5, 7

Statute:

Natural Gas Policy Act of 1978, 15 U.S.C. (Supp. IV) 3301 *et seq.* 2

  Section 2(21), 15 U.S.C. (Supp. IV) 3301(21) 2
  Section 2(21)(B), 15 U.S.C. (Supp. IV) 3301(21)(B) 2, 5
  Section 602(a), 15 U.S.C. (Supp. IV) 3432(a) 4, 5, 6

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MEMORANDUM FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE

This memorandum is filed in response to the Court's invitation to the Solicitor General to express the views of the United States.

STATEMENT

1. Petitioner, Pennzoil Company, has produced oil and gas in West Virginia for many years. Pennzoil sells most of its West Virginia natural gas production at wholesale to interstate pipelines; it also sells a small quantity of the natural gas it produces in West Virginia at retail through its local distribution division (Utility Division).[1] This case concerns the pricing of those local retail sales.

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[1] In addition to the gas that Pennzoil itself produces in West Virginia, Pennzoil purchases and resells gas from approximately 140 other independent producers in that State. It also operates a large gathering system through which it transports its own production as well as its purchased gas. The gas sold at retail to West Virginia customers by Pennzoil's Utility Division is identified by accounting entries from Pennzoil's production and transportation facilities to the Utility Division's distribution facilities.

Pursuant to a contract entered into in 1930, Pennzoil agreed to sell its West Virginia production to an interstate pipeline purchaser, reserving, however, such gas as was needed to fulfill its local obligations.[2] In August 1976, this 1930 contract was replaced by a contract that explicitly excluded from the agreement gas necessary to meet Pennzoil's local retail commitments.

2. In a 1980 West Virginia rate proceeding involving the Utility Division's intrastate rates, Pennzoil sought to have its own production, when sold by the Utility Division to retail customers, priced at levels established by Congress in the Natural Gas Policy Act of 1978, 15 U.S.C. (Supp. IV) 3301 *et seq.* (NGPA). Pennzoil claimed that such sales of pipeline produced gas constitute "first sales" within the meaning of Section 2(21) of the NGPA, 15 U.S.C. (Supp. IV) 3301(21). The West Virginia Public Service Commission (PSC) rejected Pennzoil's request (Pet. App. 1b-30b).

The PSC noted that in enacting the NGPA, Congress drew a distinction "between a pipeline or distributor's producer or field [*i.e.*, wellhead] sales and other sales" that remain subject to the jurisdiction of the Federal Energy Regulatory Commission [FERC] or state commissions (Pet. App. 19b). Thus, in Section 2(21)(B) of the NGPA, 15 U.S.C. (Supp. IV) 3301(21)(B), Congress provided that a "first sale"

> * * * shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.

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[2] The 1930 contract was filed as FPC Gas Rate Schedule No. 3, Docket No. IP No. 2484, on October 7, 1959.

The PSC observed (Pet. App. 19b-21b) that in Order No. 58,[3] the FERC interpreted this statute to mean that a sale of natural gas by a pipeline is "attributable" to the pipeline's own production only to the extent that the sale is comprised exclusively of that production.

Applying the FERC's interpretation, the PSC concluded that because the gas Pennzoil produces is commingled with the gas it purchases from others, Pennzoil is disqualified "from claiming first sale treatment for the sales it makes from its general system supply" (Pet. App. 21b). The PSC rejected Pennzoil's argument that it could treat as a first sale the intracorporate transfer of gas it produces from one division of the company to another (*id.* at 22b). Noting that the FERC had rejected a similar contention on the ground that "the regulation and enforcement of rates for sales of pipeline production should not be dependent on an event that is recorded solely on the books and records of the Company and that occurs without contract, bargaining, or certification," the PSC found no reason to reach a different conclusion (*ibid.*).

In addition, the PSC found that its "authority and duty to establish the appropriate price for Pennzoil to include in its rates and charges for its own produced gas sold to its West Virginia retail customers has not been preempted by NGPA, the [Natural Gas Act], or the FERC, through its regulations and orders issued pursuant thereto" (Pet. App.

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[3] Order No. 58 was vacated by the United States Court of Appeals for the Fifth Circuit in *Mid-Louisiana Gas Co.* v. *FERC*, 664 F. 2d 530 (1981), petitions for cert pending *sub nom. Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, No. 81-1889 (filed Apr. 12, 1982); *Arizona Electric Power Cooperative, Inc.* v. *Mid-Louisiana Gas Co.*, No. 81-1958 (filed Apr. 23, 1982); *Michigan* v. *Mid-Louisiana Gas Co.*, No. 81-2042 (filed May 3, 1982); *FERC* v. *Mid-Louisiana Gas Co.*, No. 82-19 (filed July 6, 1982).

25b).[4] The net effect of the PSC's decision was to continue Pennzoil's production, to the extent sold at retail through its Utility Division, on a cost-based rate. This rate is somewhat lower than NGPA prices.

3. Pennzoil sought review of the PSC's decision in the West Virginia Supreme Court of Appeals, arguing that (1) the NGPA required the PSC to authorize collection of the Title I rate, and (2) the PSC's cost-based determination was in error. The West Virginia court summarily denied Pennzoil's petition for an appeal, stating only that it was "of opinion that [Pennzoil] has not shown itself entitled to the relief prayed for in its * * * petition" (Pet. App. 1a).

After the Fifth Circuit's decision in *Mid-Louisiana Gas Co.* v. *FERC*, 664 F. 2d 530 (1981), petitions for cert. pending, Nos. 81-1889, 81-1958, 81-2042 and 82-19, which vacated FERC Order No. 58 interpreting the statutory term "first sale" as applied to pipeline and distributor produced gas, Pennzoil sought reconsideration by the West Virginia Supreme Court of Appeals. The court summarily denied this request (Pet. App. 1c).

DISCUSSION

Petitioner contends that the judgment of the Supreme Court of Appeals of West Virginia in this case presents two questions concerning the proper construction of the NGPA that warrant review by this Court. We note, however, that the West Virginia court did not issue an opinion in this case or otherwise explicitly address the questions presented in the petition. Instead, the court below summarily affirmed the order of the West Virginia Public Service Commission, without setting forth the grounds for that disposition. Because PSC asserts (Br. in Opp. 6-8) that, in opposing petitioner's appeal in the court below, it presented reasons for denying relief solely as a matter of state law, there is a substantial question in this case whether the judgment of the West Virginia court rests on an independent and adequate state ground. Accordingly, the Court may wish to remand the case to the state court for clarification concerning the basis for the judgment below.

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[4] This was an apparent reference to Section 602(a) of the NGPA, 15 U.S.C. (Supp. IV) 3432(a), which provides that "[n]othing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter." The state hearing examiner had relied, in part, on that provision in rendering his decision (Pet. App. 22f).

Assuming that in entering its judgment the court below decided the two questions presented in the petition, we note that the first question, concerning the proper construction of the statutory definition of "first sale" in Section 2(21)(B) of the NGPA, 15 U.S.C. (Supp. IV) 3301(21)(B), is similar to that presented in the petitions for certiorari seeking review of the Fifth Circuit's decision in *Mid-Louisiana Gas Co.* v. *FERC, supra.* In the petition filed on behalf of the FERC in that case (No. 82-19), we have argued that the decision of the Fifth Circuit, on which Pennzoil relies here (Pet. 16-17), is contrary to the intent of Congress in enacting the NGPA.[5] In these circumstances, the Court may wish to defer acting on the instant petition pending disposition of the petitions in *Mid-Louisiana*.

Petitioner also argues (Pet. 20-28) that if the transactions at issue are deemed "first sales" within the meaning of the NGPA, the PSC had no authority under Section 602(a) of the Act, 15 U.S.C. (Supp. IV) 3432(a), to set a maximum lawful price for those transactions at a level below that established for "first sales" under the NGPA. Given the present posture of the case, however, there is no need for the

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[5] We are sending ~~petitioner a copy~~ the parties copies of our petition in *Mid-Louisiana*.

Court to reach this issue. If the Court grants certiorari in *Mid-Louisiana* and reverses the judgment of the Fifth Circuit in that case, petitioner's Section 602(a) argument would fall of its own weight, since that argument rests on the assumption that the transactions at issue qualify as "first sales." Only if the Court denies certiorari in *Mid-Louisiana* or affirms the judgment of the Fifth Circuit in that case would it be necessary to decide whether to grant certiorari on the Section 602(a) issue. In the latter event, we would submit that, even if it could be said that the court below "decided" the Section 602(a) issue, because that issue has not been addressed by any other court it has not been the subject of sufficient judicial attention to warrant review by this Court at the present time. Accordingly, we believe that it would be prudent for the Court to await further developments in the lower courts before addressing the Section 602(a) issue.

Finally, we note that petitioner's Section 602(a) argument is based on the proposition (Pet. 21-22) that the sales of gas to its retail customers in West Virginia take place "in interstate commerce" because that gas is commingled with gas sold to interstate pipelines for resale in interstate commerce. Because neither the court below nor the PSC expressly determined that the transactions at issue are "in interstate commerce," we doubt whether this Court should undertake to resolve this fact-bound issue in the first instance.

CONCLUSION

The Court may wish to remand the case to the Supreme Court of Appeals of West Virginia for clarification whether the judgment of that court rests on independent and adequate state grounds. In the alternative, the Court should hold this petition pending disposition of the petitions for a writ of certiorari in *Mid-Louisiana Gas Co.* v. *FERC, supra.*

Respectfully submitted.

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Federal Energy Regulatory Commission

JULY 1982

Docket Sheet

NO. 81-1672-CSX
See: 81-1889
81-1958

TITLE Pennzoil Company, Petitioner
v.
Public Service Commission of West Virginia

DOCKETED
Mar. 10, 1982

COURT
Supreme Court of Appeals of West Virginia

DATE	PROCEEDINGS AND ORDERS
	Counsel for Petitioner: Bruce F. Kiely
	Counsel for Respondent: Robert R. Rodecker , Richard A. Solomon
Mar. 10, 1982	Petition for writ of certiorari filed.
Mar, 10, 1982	Appendix filed.
Apr. 9, 1982	Brief for the respondent in opposition filed.
Apr. 14, 1982	DISTRIBUTED. 4-30.
Apr. 28, 1982	Reply brief for the petitioner filed. (D).
May 3, 1982	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
July 28, 1982	Memorandum for the U. S. and the FERC as amici curiae filed.
Aug. 4, 1982	DISTRIBUTED. SL15P1.
Sept. 24, 1982	Supplemental brief of petitioner filed. (D).